Annual Report: Budget Review

Board of Governors of the Federal Reserve System

1985–86

Preface

The purpose of this document is to bring together information about the Federal Reserve System's spending and budgetary processes to assure its accessibility to the public and to congressional oversight committees. Most of the information about the 1986 budget of the Board of Governors and the Reserve Banks was made available to the public when the budgets were discussed and approved in final form by the Board in open meetings. Efforts have also been made to provide sufficient descriptive information and historical data to serve as a background for assessing the 1986 budgets. Various technical appendixes have been included to describe the budget and accounting procedures, the conventions, and the rationale used by the System in planning its expenses.

This is the first time the Board of Governors has issued a comprehensive *Budget Review*. We welcome suggestions to improve the usefulness of future editions.

Contents

Chapter 1
Introduction

This report describes the budget and budgetary processes of the Federal Reserve System. The information it contains, while publicly available from a variety of sources, has been consolidated in the interest of giving a single, complete picture of expenditures incurred by the Federal Reserve.

The Federal Reserve System comprises the Board of Governors in Washington, D.C., and 12 regional Federal Reserve Banks with 25 branches. The System was created by the Federal Reserve Act, passed by the Congress in 1913, to establish more effective supervision of banking and a safer and more flexible banking and monetary system.

From the inception of the Federal Reserve, its purposes clearly were aspects of national economic and financial objectives. Over the years, stability and growth of the economy, a high level of employment, stability in the purchasing power of the dollar, and reasonable balance in transactions with foreign countries have come to be recognized as primary objectives of economic policy. These objectives have been articulated by the Congress in the Employment Act of 1946 and, more recently, in the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act).

Key amendments to the Federal Reserve Act have also been set forth in the Banking Act of 1935, the 1970 Amendments to the Bank Holding Company Act, the International Banking Act of 1978, and the Depository Institutions Deregulation and Monetary Control Act of 1980.

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through its ability to influence banking and financial conditions in the economy. As the nation's central bank, it attempts to ensure that growth in money and credit is sufficient to encourage expansion in the economy in line with its potential and with price stability. Finally, as the nation's lender of last resort, the Federal Reserve has the responsibility of forestalling national liquidity crises and financial panics.

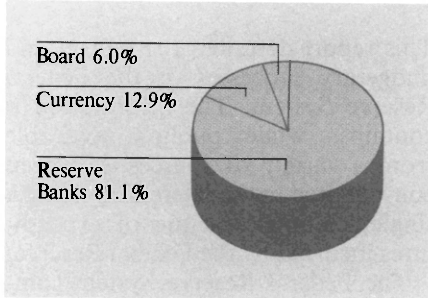
Because a sound financial structure is an essential ingredient of an effective monetary policy and a growing and prosperous economy, the Federal Reserve has been entrusted with a variety of supervisory and regulatory functions. Among other things, it administers the laws that regulate all bank holding companies; it supervises state-chartered member banks; it regulates the foreign activities of all U.S. banks and the U.S. activities of foreign banks; and it establishes rules to ensure that consumers are adequately informed and treated fairly in certain credit transactions.

The Federal Reserve System also plays a major role in the nation's payments mechanism. The Federal Reserve Banks distribute currency and coin, process 37 percent of all domestic checks, and provide electronic funds transfers amounting to about $435 billion daily, including both wire transfers and automated clearinghouse payments. In addition, the Federal Reserve System serves as the fiscal agent for the U.S. Treasury and provides a variety of financial services for the Treasury and other government agencies.

To carry out these responsibilities the Federal Reserve System spent an estimated $1.2 billion in 1985 and has budgeted expenses for 1986 of $1.3 billion. These are the totals of expenses for the Board of Governors and the Federal Reserve Banks and do not reflect revenue of $603 million in 1985 and $617 million in 1986 from priced services. By function, the 1986 budget provides $156 million, or 12 percent, for monetary policy; $194 million, or 15 percent, for supervision and regulation of financial institutions; $777 million, or 61 percent, for services to the public and financial institutions; and $142 million, or 11 percent, for services to the U.S. Treasury and other government agencies.[1]

The Monetary Control Act of 1980 requires that the Federal Reserve Banks charge depository institutions fees equivalent to the full costs incurred in providing most payments services, plus an imputed return on capital that would have been provided and taxes that would have been paid by private firms offering similar services. In 1986, earnings from these services are expected to offset $494 million in operating expenses, equivalent to about 39 percent of total Federal Reserve expenses. The Treasury and other government agencies also partially reimburse the Federal Reserve for services it provides them. These receipts, which were $92 million in 1985, are expected to amount to $107 million in 1986. Thus net expenses for the year are expected to be $668 million, or 5.2 percent more than in 1985. This is the result of subtracting from the $1.3 billion in budgeted expenses those expenses that will be offset by service fees and reimbursements.

Chart 1.1
Budget for the Federal Reserve System, Total, 1986



The major source of Federal Reserve income, estimated at $18.1 billion in 1985, is earnings on the portfolio of the System Open Market Account. This portfolio of U.S. government securities is used in conducting open market purchases and sales to implement monetary policy. The Federal Reserve returns earnings in excess of expenses, dividends, and surplus to the U.S. Treasury each year; in 1985, the Federal Reserve returned $17.8 billion in such earnings.[2]

The next chapter discusses actual System expenses and receipts in 1984; estimates for 1985, the budget year just completed; and the budget for 1986. Chapters 3 and 4 examine the budgets of the 12 Reserve Banks and of the Board of Governors respectively. Chapter 5 discusses employment patterns at the Federal Reserve Banks

1. These numbers do not include $187 million in outlays for Federal Reserve currency (see chart 1.1).

2. These earnings are treated as receipts by the Treasury and appear in the U.S. budget as estimated by the Office of Management and Budget.

and the Board, especially changes over the last several years. Special appendixes to these chapters discuss certain technical matters, such as the pricing of Federal Reserve services and the budget and accounting conventions used by the System, and set forth other supporting data.

Chapter 2

Expenses of the Federal Reserve System

This chapter examines the expenses of the Federal Reserve System as a whole in order to give an overview of the System's major functions and the expenses incurred in supporting them. The expenses of the Federal Reserve Banks and the Board of Governors taken together are presented for four main operational activities: monetary and economic policymaking, supervision and regulation of financial institutions, services to financial institutions and the public, and services to the U.S. Treasury and government agencies. Each of these functions is described briefly to set the stage for the detailed discussion of Reserve Bank and Board expenses in chapters 3 and 4.

Separate appendixes to this chapter discuss the Federal Reserve's expenses for printing currency, a charge from the Bureau of Engraving and Printing; System capital outlays;[1] System sources and uses of funds; and the auditing to which the System is subject.

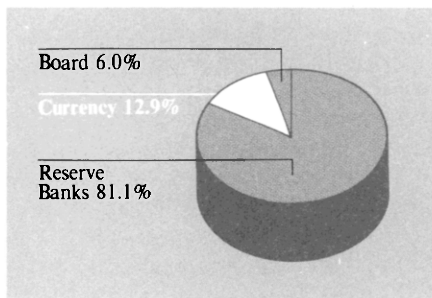
The Reserve Banks and the Board of Governors all use the calendar year as the basis for planning, budgeting, and control. Although the budget processes differ for the Board and the Banks, all the budgets, along with Federal Reserve currency costs, are presented to the Board of Governors for review and approval in accordance with rigorous accountability procedures and with the Federal Reserve Act. The procedures for the Reserve Banks are discussed in appendix 3.A, and those for the Board are discussed in appendix 4.A.

1. The System follows generally accepted accounting principles and thus capitalizes and depreciates major capital assets.

Overview of the System

Within the total of all costs of the Federal Reserve System under the 1986 budget, the Board accounts for 6.0 percent, the Federal Reserve District Banks taken together for 81.1 percent (chart 2.1).

Chart 2.1
Budget for the Federal Reserve Board and Banks, 1986

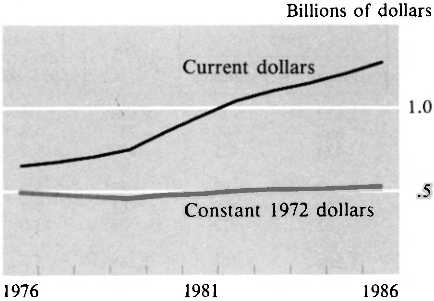


Trends in Expenses and Employment

Over the 10 years 1977–86, total expenses of the Board and the Banks are expected to increase at an average annual rate of 6.9 percent in current dollars and 0.8 percent when adjusted for inflation. Over the same period, System employment is expected to decrease 1,585, or 6.0 percent.

In constant dollars, System expenses actually decreased 2.3 percent a year on average between 1976 and

Chart 2.2
Expenses of the Federal Reserve System, 1976–86



1979, reflecting significant efficiencies from automation and a multiyear program to control costs (see chart 2.2). The passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 raised expenses dramatically in the years 1980 to 1983 because reserve requirements were imposed for the first time on all depository institutions and the System was required to put in place the procedures necessary for charging for its services to financial institutions. The slightly higher rate of increase embodied in the 1985 estimate and the 1986 budget reflects special efforts to strengthen supervision and regulation of banks and bank holding companies, programs to improve the payments mechanism, a Systemwide improvement in automation, and a developmental effort for the Treasury Department to achieve long-term efficiency for public-debt functions.

Table 2.1 shows the budgeted and actual expenses of the Federal Reserve System in 1984, budgeted and estimated expenses in 1985, and budgeted expenses for 1986. Actual Federal Reserve expenses totaled a little more than $1.1 billion in 1984; they are estimated at $1.2 billion in 1985, a 5.1 percent increase over 1984, and at $1.3 billion in 1986, a 5.5 percent increase over the 1985 estimate. In 1984, the expenses of the Reserve Banks and of the Board of Governors were below their approved budget levels; in 1985, they matched the budget almost exactly.[2]

The increases in System expenses in 1985 and 1986 reflect modest increases in salaries and benefits to meet the objectives noted above that are offset by savings from efforts to contain costs.

Total Federal Reserve employment has declined on balance over this same period, 1976–86 (see chart 2.3). Between 1976 and 1979, employment declined 2,081, or 7.8 percent. But the initial adjustment to the Monetary Control Act in 1980 and 1981 required an increase in employees to handle the increase in data reporting, the maintenance of thousands of new accounts, and the establishment of new pricing and billing procedures. After that, significant losses in volume, largely in check processing, resulted in declines in employment in 1982 and 1983 that more than offset the increases of the previous two years. Employment is expected to rise slightly in 1985 and 1986 primarily because of special efforts in the area of supervision and regulation and improvements in the payments mechanism.

Net System Expenses

Table 2.2 shows net System expenses for 1984–86 after reimbursement by the Treasury and other government agencies for services and recovery of costs through fees imposed on deposi-

2. The System views budgets as targets that, if realistic, have some margin for error either way. Close monitoring during the budgetary control phase provides management information that allows for corrective action.

Table 2.1
Total Expenses of the Federal Reserve System and Cost of Currency, 1984–86[1]
Millions of dollars, except as noted

Entity and type of expense	1984		1985		1986 Budget	Percent change, 1985–86
	Budget	Actual	Budget	Estimate		
Reserve Banks[2]	1,086	1,068	1,122	1,120	1,182	5.5
Personnel	671	664	698	699	733	4.8
Nonpersonnel	415	403	424	421	450	6.7
Board of Governors[3]	78[4]	77	82	82	87	5.4
Personnel	57	57	60	60	61	2.2
Nonpersonnel	21	20	22	22	26	13.0
Total System expenses	**1,164**	**1,145**	**1,204**	**1,203**	**1,269**	**5.5**
Personnel	**728**	**721**	**758**	**759**	**793**	**4.5**
Nonpersonnel	**436**	**423**	**446**	**443**	**476**	**7.4**
Federal Reserve currency[5]	195	163	174	174	187	7.4

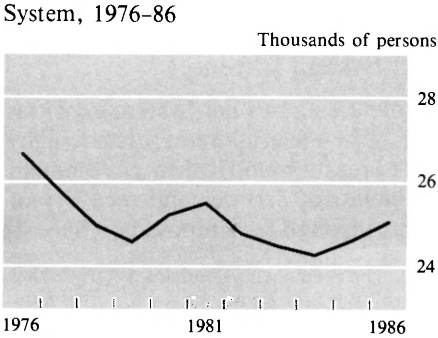
1. Details may not add to totals because of rounding.
2. For detailed information see chapter 3.
3. For detailed information see chapter 4.
4. The Board of Governors did not depreciate assets before 1985, and the budget estimate has been adjusted to reflect the subsequent inclusion of depreciation during 1984.
5. For detailed information see appendix 2.A.

tory institutions for use of the payments-mechanism services the System provides.

Reimbursements for Federal Reserve operating expenses are received primarily from the Treasury for services that the Reserve Banks perform as fiscal agents of the U.S. government, as discussed below. The projected increase in reimbursements reflects a new service for the Treasury, the direct access book-entry system (T-DAB), to be inaugurated in mid-1986 (described at the end of this chapter), and a change in accounting treatment for the commercial book-entry service (a reimbursable fiscal service beginning in October 1985). The change in recovery of costs for priced services reflects modest increases in personnel and other costs.

Revenue from priced services, reported in table 2.3, reflects projections of small growth in volume and a few minor price increases.

Chart 2.3
Employment in the Federal Reserve System, 1976–86



1976–84 employment data from internal assessment study.

Major Operational Areas

In 1977, the Federal Reserve Banks implemented the Planning and Control System (PACS), a sophisticated program of budgeting and cost accounting. PACS segregates Reserve Bank expenses into the four major service lines discussed below. Under PACS, all support and overhead costs are fully distributed or allocated to these service lines. For presentation purposes, data for the Board's budget and expenses have been aligned with

Table 2.2
Expenses of the Federal Reserve System Net of Recoverable Expenses, 1984–86
Millions of dollars, except as noted

Item	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Total System expenses	1,145	1,203	1,269	5.5
Less:				
Operating expenses reimbursable by prearranged agreements	84	92	107	16.5
Operating expenses recovered from priced-service fees [1]	454	476	494	3.8
Net System expenses	**607**	**635**	**668**	**5.2**

1. Operating expenses include direct, support, and overhead expenses. Imputed costs that must be included in fees for priced services are not part of operating expenses; these are interest on items credited before collection (float), and taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm (the private sector adjustment factor, detailed in appendix 3.D). Details may not add to totals because of rounding.

Table 2.3
Revenue from Priced Services, 1985 and 1986[1]
Millions of dollars

Service	1985 Estimated	1986 Projected
Funds transfer and net settlement	65.1	68.2
Automated clearinghouse	22.5	26.8
Commercial check	453.3	475.7
Book-entry securities	24.5	8.1
Definitive securities	7.5	8.7
Noncash collection	14.1	14.7
Cash services	15.9	15.3
Total, all services [2]	**602.7**	**617.4**

1. Details may not add to totals because of rounding. Includes revenue offsetting both operating cost and the PSAF. (See table 2.2, note 1.)

2. Does not include $111 million of estimated revenue from clearing balances held with the Reserve Banks for the purpose of using priced services.

the PACS functions of the Reserve Banks. The one exception is System policy direction, a function that is unique to the Board and not recognized under PACS.[3] Table 2.4 summarizes the total expenses of the Federal Reserve System for each service line, and chart 2.4 shows the distribution of expenses. A description of each operational area and of expenses incurred follows.

3. For data and a discussion of this subject, see table 2.4 and chapter 4.

Monetary and Economic Policy

The monetary and economic policy service line includes the activities of the Board and the Reserve Banks that support the formulation and implementation of monetary policy. The System has several tools to affect the availability and cost of money and credit. The Federal Open Market Committee (FOMC), comprising the seven Board members and five Reserve Bank presidents, meets every six weeks or so in Washington to set policies for System open market operations, the most important monetary

Table 2.4
Expenses of the Federal Reserve System, by Service Line, 1984–86[1]
Millions of dollars, except as noted

Service line and entity	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Monetary and economic policy	150.9	149.8	155.6	3.9
Reserve Banks	99.4	93.9	97.8	4.2
Board of Governors	51.5	55.9	57.8	3.4
Supervision and regulation	162.9	175.1	193.9	10.7
Reserve Banks	140.7	152.0	168.6	10.9
Board of Governors	22.2	23.1	25.3	9.8
Services to financial institutions and the public	704.6	743.2	777.3	4.6
Reserve Banks	701.5	740.0	773.9	4.6
Board of Governors	3.1	3.2	3.4	8.2
Services to U.S. Treasury and government agencies by Reserve Banks[2]	126.3	134.6	141.9	5.4
Total System expenses	**1,144.6**	**1,202.6**	**1,268.7**	**5.5**
Reserve Banks	**1,067.8**	**1,120.4**	**1,182.1**	**5.5**
Board of Governors	**76.8**	**82.2**	**86.6**	**5.4**

1. Service lines are fully costed, reflecting all support and overhead allocations.

The Board of Governors service line, System policy direction, which is shown separately in chapter 4, has been allocated across service lines above. As a result the numbers in chapter 4 for the service lines are not the same as the ones listed in this table.

Details may not add to totals because of rounding.

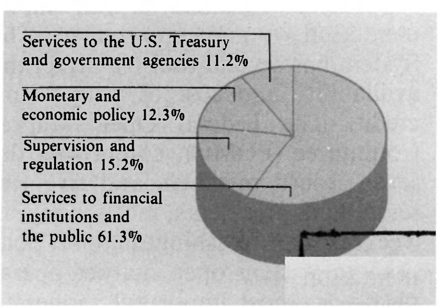
2. This service line is performed only by the Federal Reserve Banks.

policy tool. In addition, the Board is responsible for changes in reserve requirements and must act on requests from the Federal Reserve Banks to fix discount rates.

The System collects a vast amount of banking and financial data which are used to help analyze conditions in the banking, money, and capital markets. This information flows through the Reserve Banks to the Board, where it is compiled and made available to the public for analyzing financial conditions. The Board produces a variety of weekly and monthly statistical releases on topics such as the monetary aggregates and exchange rates.

The research staffs at the Board and the Reserve Banks regularly use this information about banking and financial markets, and other economic data collected by the federal government and private agencies, to assess the state of the economy and the relationships between the financial markets and economic activity. In addition, they conduct longer-run economic studies bearing on macro- and microeconomic questions at the regional, national, and international levels.

Chart 2.4
Expenses of the Federal Reserve System, by Service Line, 1986 Budget



Also, in conjunction with the FOMC meetings, the staff prepares detailed economic and financial analyses and projections for the domestic economy and international markets as background for policy or tactical decisions; at times they conduct special analyses and forecasts for the Committee. The Board staff regularly prepares special reports and briefings for the Board, and Reserve Bank staffs do similar work for the senior officers and boards of directors of their Banks.

In addition, economists and others working in the area of monetary and economic policy routinely analyze various sectors of the U.S. economy, as well as legislative and regulatory proposals on a broad variety of issues that may have an impact on monetary policy. From time to time congressional committees call on the Board staff for special studies. Economists at the Reserve Banks undertake studies of their regional economies and prepare research papers about economic and monetary policy for distribution to member banks and the public.

For 1986, the budgeted cost for this service line is $155.6 million, compared with estimated expenses in 1985 of $149.8 million, an increase of 3.9 percent. Reflected in the increase are projects at the Banks and the Board for processing and analyzing data in a more timely and effective way. Employment is expected to be flat at the Banks and to decrease at the Board.

Supervision and Regulation

The Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. This function is based primarily on responsibilities and powers contained in the Federal Reserve Act, the Banking Acts of 1933 and 1935, the Bank Holding Company Act of 1956 (and amendments of 1966 and 1970), and the Bank Merger Act of 1960.[4]

The Federal Reserve accomplishes its mission through a variety of activities, including onsite examinations and inspections of member banks and bank holding companies; offsite surveillance and monitoring of financial institutions; review of applications for mergers, acquisitions, and changes in control; formal supervisory actions; and adoption and enforcement of regulations to carry out statutory directives.[5] Beyond these mandated activities the supervisory process entails ongoing oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader commitment is reflected in the Federal Reserve's role as lender of last resort and in the System's presence in financial markets through open market operations.[6]

4. The Federal Reserve is primarily responsible for the supervision and examination of state-chartered member banks, while the Comptroller of the Currency oversees national member banks and the Federal Deposit Insurance Corporation oversees nonmember insured banks. Representatives of these agencies, along with representatives of the Federal Home Loan Bank Board and the National Credit Union Administration, form the Federal Financial Institutions Examination Council, a coordinating body for interagency examination policy.

5. The Board's approval is also generally required for the conduct of activities that may be deemed permissible by the Federal Reserve for bank holding companies if they are "closely related to banking." Federal Reserve approval is also required for expansion of bank holding companies through acquisitions of banks or of nonbanking firms engaged in permissible activities. Geographic limits on banking are enforced by these mechanisms.

6. The Monetary Control Act of 1980 extended discount-window privileges to all depository financial institutions with liabilities subject to reserve requirements.

Supervisory and regulatory activities are carried out by the Board and the Federal Reserve Banks. The Board is responsible for setting policy, and the Banks conduct examinations and implement other supervisory programs, which focus on management and asset quality and on overall earnings, liquidity, and capital conditions. Information on the condition and income of banks and bank holding companies is periodically collected, processed, and made available to the public.

To carry out these responsibilities, in 1985 the Board and the Banks conducted an estimated 750 examinations of state member banks, 1,600 inspections of bank holding companies and their subsidiaries, and 2,300 reviews of bank holding company applications.

The Board enforces compliance by member banks with the major federal laws protecting consumers in their use of credit, such as the Truth in Lending Act, which requires disclosure of the full cost of borrowing, and the Equal Credit Opportunity Act, which prohibits discrimination in granting credit. Examinations of about 750 banks are conducted each year.

The Federal Reserve Board also maintains contact with the central banks of other countries and with organizations concerned with the international monetary system. The Board's supervisory responsibilities extend to foreign operations of U.S. banks and, under the International Banking Act, to foreign bank operations in the United States.

As table 2.4 shows, budgeted costs for this service line are $193.9 million in 1986, compared with estimated expenses of $175.1 million in 1985. The increase is due largely to the Board's recently announced policy of intensifying the supervision of state member banks and bank holding companies. Such action has been deemed necessary in light of trends within the banking industry over the past several years, including the well-publicized increase in the number of failing and problem banks.

Specifically, the Board has responded to these conditions by increasing the frequency and scope of Federal Reserve onsite examinations and strengthening the procedures for reporting deficiencies to bank managements and boards of directors via onsite meetings. These steps are intended to promote early identification of problems in banking organizations and expeditious correction of weaknesses through more frequent and clearer communications between bank supervisors and boards of directors. To respond to the growing workload, the System will add an average of 180 personnel to its supervisory staff in 1986, and will improve training programs for examiners.[7]

Services to Financial Institutions and the Public

The Federal Reserve System not only is a major participant in the nation's payments mechanism but also contributes to innovation and efficiency in that field. The payments mechanism consists of systems designed to move funds among financial institutions across the country. The Federal Reserve participates by distributing currency and coin, collecting checks, operating electronic funds transfer networks, and providing securities safekeeping and coupon collection services. Chart 2.5 depicts the growth

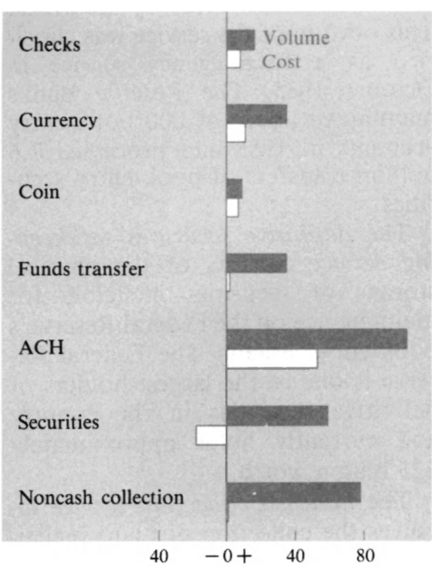
7. For further discussion of System employment, see chapter 5.

in volumes and costs of these services for the years 1982–86. The automated clearinghouse, a form of electronic payments, has had the most rapid growth, having started from a low base in 1982.

Since the implementation of the Monetary Control Act of 1980, System services have been available to all depository institutions and fees have been assessed for most of them. Two exceptions are the distribution of currency and coin, which is considered a unique central bank function, and the provision of Treasury book-entry services.

The Federal Reserve is responsible for ensuring that the economy has enough *currency and coin* to meet the public's demand for cash. Sophisticated, automated equipment is used to count currency, identify counterfeit currency, and destroy currency that is unfit for circulation. In 1984, the Reserve Banks paid out $181.4 billion in currency and $3.8 billion in coin and destroyed $22.4 billion of unfit currency.

Chart 2.5
Percent Change in Cost and Volume of Federal Reserve Services to Financial Institutions and the Public, 1986 Budget from 1982 Actual



Calculation of change is made in constant dollars.

The Federal Reserve Act of 1913 specifically authorizes the Reserve Banks to *collect and clear checks.* According to the legislative history of the act, the Congress intended the Federal Reserve to eliminate inefficiencies and remove inequities in the payments mechanism. The passage of the Monetary Control Act of 1980 reinforced the congressional directive that the Federal Reserve participate in the payments mechanism—with the additional objective of stimulating competition.

Today, approximately 15 billion of the 40 billion checks written in the United States each year are cleared by the 12 Reserve Banks and their Branches and regional check-processing centers. Their average daily value is $43.3 billion. The majority of the checks deposited with the Federal Reserve are collected on the day they are deposited or on the next business day. This performance is made possible by highly automated check-sorting equipment and efficient ground and air transportation networks.

In an effort to reduce the time of the "holds" banks place on checks deposited with them for collection, the Federal Reserve is working with the banking industry to reduce the time required to return unpaid checks to the bank of first deposit. Moreover, on October 1, 1985, the System promulgated a new regulation that requires banks that are returning large-dollar checks that they have received from the Federal Reserve to notify the bank of first deposit no later than four days following receipt of such a check. The Reserve Banks are also supporting, through pilot programs, efforts to reduce costs by terminating the practice of returning checks to their writers (so-called truncation).

Fedwire is another essential element of the nation's payments mechanism. Through Fedwire, a totally electronic means of transferring funds, depository institutions are able to draw on their reserve or clearing accounts and transfer funds to any place in the country within minutes. Approximately 6,000 depository institutions use Fedwire through direct electronic connections with Federal Reserve Banks. In turn, the Reserve Banks are linked via the Federal Reserve Communication System (FRCS-80), a distributed packet-switching network. During 1985, approximately 45 million transfers were sent over Fedwire; their aggregate value was more than $103 trillion, for an average of $2.3 million per transfer.

The Federal Reserve's *net settlement service* permits participants in private clearing arrangements to exchange and settle transactions, through reserve or clearing-account balances, on a net basis. A broad range of participants uses the service, including local check clearinghouse associations, credit card processors, automated teller machine networks, and national and regional funds transfer networks. In 1985, about 500,000 net settlement entries were processed by the Reserve Banks.

The Federal Reserve's *automated clearinghouse* (ACH) is an electronic payment service developed as an alternative to checks for making recurring payments. The ACH is used primarily for income payments, such as salaries and pensions, and for preauthorized bill payments, such as insurance premiums and mortgage payments. Approximately 22,000 depository institutions participate in the ACH. About 3,700 of these institutions originate and receive transactions via electronic connections with the Federal Reserve; the others use machine-readable magnetic tapes. In 1985, the Reserve Banks processed about 585 million ACH transactions; over 50 percent of these transactions were government payments, largely social security benefits and civilian and military pay.

The Reserve Banks also provide several securities services. The *book-entry securities service,* initiated in 1968, provides for the maintenance of Treasury and government agency securities on computer records, and enables holders of these securities to transfer them to other institutions throughout the country. Most of the book-entry securities held by the Reserve Banks are Treasury securities. This portion of the service was classified as a fiscal-agency service in October 1985. The Reserve Banks maintained about 44,000 book-entry accounts in 1985 and processed 7.6 million transfers of book-entry securities.

The *definitive securities safekeeping service* consists of the physical storage of securities ineligible for maintenance on the Federal Reserve's book-entry system. The Federal Reserve is one of the largest holders of definitive securities in the country and currently holds approximately $25 billion worth.

The *noncash collection service* involves the collection of items ineligible for processing through normal check-collection channels. The Reserve Banks collect three types of noncash items: coupons, bonds, and miscellaneous items such as bankers acceptances and certain checks and drafts. Coupon collection accounts for approximately 95 percent of the transactions; the Federal Reserve processed about 4.6 million coupon envelopes in 1985.

For 1986, expenses associated with providing services to financial institutions and the public are projected to be $777.3 million and account for 61.3 percent of Federal Reserve expenses. Expenses are expected to increase $34.1 million, or 4.6 percent, over 1985, largely because of growth in volume, the full-year impact of providing wire notification of the return of large-dollar checks, the replacement of obsolete check-processing equipment, and the implementation of a new automated funds transfer system by several Reserve Banks.

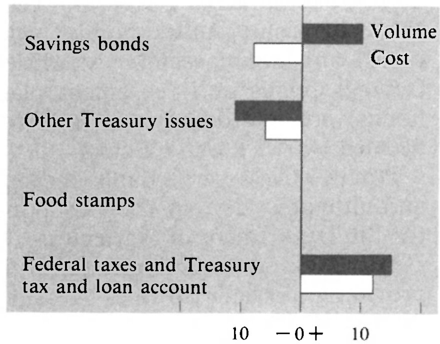
Services to the U.S. Treasury and Government Agencies

The Federal Reserve Act designates the Federal Reserve Banks as fiscal agents for the U.S. government. The Reserve Banks provide a wide range of services to the Treasury Department, which fall into two broad categories—banking services and unique services requested by the agency. Cost increases in this area, measured in constant dollars, have generally been smaller than the increases in volume (see chart 2.6).[8]

8. Volumes in this area can be greatly influenced by prevailing interest rates and by the size of the individual transaction: the cost of one transaction in Treasury issues involving large amounts of public debt may be approximately the same as that of a transaction of much smaller value. Similarly, the dollar value of food stamps destroyed may be increasing although the number of pieces is not.

Chart 2.6

Percent Change in Cost and Volume of Federal Reserve Services to the U.S. Treasury and Government Agencies, 1986 Budget from 1982 Actual



Calculation of change is made in constant dollars. Cost and volume of food stamp services did not change.

The Federal Reserve serves as the government's bank. In this capacity, the Reserve Banks maintain deposit accounts for the Treasury that are used to disburse government payments and to collect government receipts. The Reserve Banks pay all government checks, process wire transfers of funds and automated clearinghouse payments, and give the Treasury daily statements of account activity. (For cost-accounting purposes, expenses associated with handling government checks and electronic payments are included in services to financial institutions and the public.)

Numerous unique services are also provided to the Treasury. For example, in administering the Treasury tax and loan program, the Reserve Banks monitor the tax receipts deposited in the 15,600 tax and loan accounts maintained by commercial depository institutions designated by the Treasury to perform this function, hold collateral supporting those deposits, and transfer funds to the Treasury's account at its request.

The Reserve Banks also assist the Treasury in its financing of the public debt. Both marketable Treasury securities (Treasury bills, bonds, and notes) and nonmarketable securities (savings bonds and retirement plan bonds) are issued, serviced, and redeemed by the Reserve Banks.

Finally, the Reserve Banks redeem and ultimately destroy food coupons for the Department of Agriculture.

For 1986, expenses associated with providing services to the Treasury and other government agencies are expected to be $141.9 million and to account for 11.2 percent of all Federal Reserve expenses. Expenses are projected to increase $7.3 million, or 5.4 percent, over 1985 estimated expenses. Most of the increase is due to the mid-1986 implementation of a book-entry system for the safekeeping of marketable Treasury securities for individuals and small investors, called the Treasury direct-access book-entry system. In addition, at least four Reserve Banks are jointly developing a new, automated Treasury tax and loan operating system.

Appendix 2.A

Currency Printing Expense

The Federal Reserve Act stipulates that the costs associated with procuring Federal Reserve notes and issuing and retiring them will be assumed by the Federal Reserve System.

On January 1, 1983, the Reserve Banks changed their budgeting and accounting process so that they no longer included costs of Federal Reserve notes in their operating expenses. Instead, the Board assumed responsibility for all currency expenses and assesses the Reserve Banks to cover them.

Currency and coin are produced by the Bureau of Engraving and Printing and the United States Mint but are put into or retired from circulation by the Federal Reserve Banks, which use depository institutions as the channel of distribution.

Essentially, the Board must incur these expenses in order to provide the public with sufficient currency to meet its demands. In the past several years these demands have increased because of the proliferation of automatic teller machines and cash dispensers.

The Board endeavors to control these expenditures as much as possible. It consults with the Bureau of Engraving and Printing to ensure that the lowest-cost methods are used; and it monitors the currency-processing operations at the Reserve Banks, most of which now utilize high-speed note-by-note sorting equipment, to ensure that no currency is destroyed prematurely and that System guidelines on the quality of currency are being met.

In this way the Board satisfies itself each year that only the minimum number of new notes is ordered and that printing costs are minimized, both in total and on average. All related costs, such as those for transportation and packaging, are similarly monitored.

Costs associated with new currency are shown in table 2.A.1.

Table 2.A.1

Costs to the Federal Reserve of New Currency, 1984–86

Millions of dollars, except as noted

Type of cost	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Printing [1]	144.1	160.5	175.0	9.0
Shipping from Washington [2]	4.5	5.0	5.4	8.0
Reimbursement to the Treasury for issuance and retirement	1.8	1.5	1.6	6.7
System–Treasury programs to deter counterfeiting [3]	12.2	6.7	4.0	−35.5
Contingency fund [4]	....	....	.5	....
Total costs of Federal Reserve currency	**162.6**	**173.7**	**186.5**	**7.4**

1. Based on 5.9 billion notes in 1984; 6.2 billion notes in 1985; and 6.5 billion notes in 1986.

2. Includes purchasing pouches and seals for Bureau of Engraving and Printing.

3. The ACD program—advanced counterfeit deterrence.

4. Covers adjustments to other costs and those due to possible price changes.

Appendix 2.B

Capital Outlays

The Federal Reserve System accounts for its operations in accordance with generally accepted accounting principles (GAAP) used in the private sector. Federal government accounting is governed by title 2 of the General Accounting Office's *Policy and Procedures Manual for Guidance of Federal Agencies.* This document prescribes accounting principles and standards for federal agencies that are in general agreement with GAAP. One notable exception is in the area of depreciation of fixed assets.

There is no universal requirement for depreciation accounting throughout the federal government, and the cost of fixed assets is typically recorded as an expense at the time of purchase. However, title 2 specifies the use of depreciation accounting for business-like operations and for activities that recover costs from reimbursements or user charges. The Fed-

Table 2.B.1

Total Expenses of the Federal Reserve System, Federal Government Accounting Method, 1982-86[1]

Millions of dollars, except as noted

Year and entity	Total expenses	Depreciation[2]		Capital outlays	Total outlays	Percent change from previous year
		Equipment	Property			
	(1)	(2)	(3)	(4)	[(1) − (2) − (3) + (4)]	
1982						
Reserve Banks	973.6	32.7	1.8	138.4	1,064.5	....
Board of Governors	67.4	1.6	1.6	1.8	66.1	....
Total	1,041.0	34.3	16.4	140.2	1,130.6	....
1983						
Reserve Banks	1,028.5	39.7	18.9	97.2	1,067.0	.2
Board of Governors	73.3	1.8	1.6	.7	70.7	7.0
Total	1,101.8	41.5	20.5	97.9	1,137.7	.6
1984						
Reserve Banks	1,067.8	51.4	20.6	88.7	1,084.5	1.6
Board of Governors	76.8	2.0	1.6	7.9[3]	81.1	14.7
Total	1,144.6	53.5	22.1	96.6	1,165.6	2.5
1985 estimate						
Reserve Banks	1,120.4	61.4	21.2	171.8	1,209.6	11.5
Board of Governors	82.2	3.4	1.6	4.2[3]	81.4	− .4
Total	1,202.6	64.8	22.8	176.0	1,291.0	10.8
1986 budget						
Reserve Banks	1,182.1	74.7	23.4	231.4	1,315.4	9.6
Board of Governors	86.6	5.1	1.6	18.2[4]	98.0	20.4
Total	1,268.7	79.9	25.0	249.6	1,413.5	9.5

1. Details may not add to totals because of rounding.
2. The Board of Governors did not depreciate capital assets before 1985; data for earlier years are estimated and subject to change (see text).
3. The Board's capital expenditures increased sharply in 1984 as a result of outlays for equipment for the Contingency Processing Center. The establishment of this facility also affected expenditures in 1985.
4. Includes an estimated $14 million for a new computer system.

eral Reserve meets both these criteria, and the Banks and the Board depreciate the cost of fixed assets over their estimated useful lives.

The Federal Reserve Banks capitalize and depreciate all capital assets that have a cost of $1,500 or more and, at their option, capitalize or expense capital assets costing less than $1,500; the capitalization guideline for the Board of Governors is $1,000. Capitalizing and depreciating assets are consistent with generally accepted accounting principles that recognize that the costs of acquiring an asset that is expected to benefit an entity over future periods should be systematically allocated to those periods. Such treatment also provides for a more realistic measurement of the operating performance of an entity.

Capital budgeting by the Reserve Banks is part of a multiyear process of identifying long-term capital requirements. On an annual basis, the Banks are required to budget for capital outlays by capital class in order to provide the Board with the estimated effect of total operating and capital spending. During the budget year, major capital purchases must be submitted to the Board for further review and approval.

Table 2.B.1 reflects the pattern of total System outlays in recent years based on the practice followed most often in the federal government. To obtain total outlays, depreciation costs were subtracted from total expenses for each year and capital outlays (actual or projected) were added. As a result, capital outlays are shown in total in the year of purchase rather than spread over the useful lives of the assets, and thus the amounts—and percent changes—vary widely from year to year.

Appendix 2.C

Sources and Uses of Funds

As noted in appendix 2.B, the Federal Reserve Banks follow generally accepted accounting principles as appropriate for commercial financial institutions, varying only in those cases that might be unique to a central bank. The Banks accrue income and expenses and capitalize acquisitions of assets whose useful lives extend over future years.

The income of the Reserve Banks is derived primarily from U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. On average these earnings account for approximately 95 percent of total current income. Current expenses include the cost of earnings credits granted to depository institutions on clearing balances held by the Reserve Banks.

A profit and loss account is used by the Reserve Banks to record extraordinary gains or deductions from current net income. The primary entries are for gains or losses on the sale of U.S. government securities, and gains or losses on assets denominated in foreign currencies that result either from the sale of those assets or from their revaluation at market exchange rates.

The Banks maintain a surplus account to cushion unexpected losses much the same as commercial establishments have retained earnings. The surplus account is increased or decreased in order to keep it at an amount equal to the paid-in capital of the member banks, which is the current level of the account stipulated by the Board of Governors.

Table 2.C.1 summarizes the actual income and expenses for 1984 and the estimates for 1985.

Preliminary figures indicate that in

Table 2.C.1

Distribution of the Income of the Federal Reserve System, 1984 and 1985[1]

Millions of dollars

Item	1984	1985 Estimate
Current income[2]	18,069	18,132
LESS:		
Current net expenses of Reserve Banks[3]		
Operating expenses	984	1,024
Cost of earnings credits	119	102
EQUALS:		
Current net income	16,966	17,005
PLUS:		
Net additions to or deductions from (−) current net income[4]	−413	1,302
LESS:		
Assessments by Board		
Board expenses	82	77
Cost of Federal Reserve currency	163	174
Other distributions		
Dividends paid to member banks[5]	93	103
Transfers to or from surplus[6]	163	155
Payments to U.S. Treasury	**16,054**	**17,798**

1. Details may not add to totals because of rounding.
2. Includes income from U.S. government securities, loans, priced services, and foreign currencies.
3. Net of reimbursements from the Treasury and other government agencies.
4. This account is the same as the "Net additions to or deductions from current net income" reported in table 7 of the Board's *Annual Report* to the Congress and includes gains or losses on foreign exchange transactions, due mainly to revaluations to market exchange rates; gains or losses on sales of U.S. government securities; and miscellaneous gains or losses. A gain of $1.2 billion on foreign exchange transactions in 1985 versus a $455 million loss in 1984 primarily accounts for the difference between the two years.
5. The Federal Reserve Act requires the Federal Reserve to pay dividends to member banks at the rate of 6 percent of paid-in capital.
6. Each year the Federal Reserve transfers to its surplus account an amount sufficient to equate surplus with paid-in capital. The purpose of this account is to provide a reserve against losses.

1985, current income before expenses, dividends, additions to surplus, and payments to the Treasury totaled $18.1 billion. Statutory dividends to member banks were $103 million; additions to surplus were $155 million; and payments to the Treasury were $17.8 billion.

Under the policy established by the Board of Governors at the end of 1964, all net income after the statutory dividend to member banks and the amount necessary to equate surplus to paid-in capital is transferred to the Treasury as interest on Federal Reserve notes.

Appendix 2.D

Federal Reserve System Audits

The Federal Reserve System is subject to several levels of audit and review. Each Federal Reserve Bank employs a full-time staff of auditors who report directly to its board of directors. The Federal Reserve Board audits the financial operations of the Reserve Banks on a regular basis and conducts periodic reviews of all other operations of the Banks. The Board itself is subject to review by its own internal audit staff and operations review staff and to an annual audit of its financial operations by an independent auditor.

Beginning in 1978, most of the operations of the Federal Reserve System became subject to review by the General Accounting Office (GAO) with the passage of Public Law 95-320, the Federal Banking Agency Audit Act. GAO currently has 18 projects in various stages of completion, and since 1978 it has completed 30 reports dealing with various aspects of the operations of the Federal Reserve. These projects and reports are shown in tables 2.D.1 and 2.D.2 respectively. In addition, the GAO has involved the Federal Reserve in over 50 other reviews not directly related to the System and has terminated 19 others before completion. Copies of the GAO reports are available directly from that agency.

Table 2.D.1
Active GAO Projects Related to the Federal Reserve

Subject	Date initiated
Federal supervision of trust departments and investment companies	1/6/83
International coordination of bank supervision	12/13/83
Federal reserve supervision of bond dealers	2/22/84
Self-regulatory organizations	2/28/84
Export Trading Company Act of 1982	8/2/84
U.S. government's function as lender of last resort	8/21/84
Federal deposit insurance programs	10/1/84
Bank-insulation strategies	12/11/84
CPA audits of banks	2/15/85
Risks in the commercial banking industry	2/27/85
Bank Secrecy Act compliance	3/28/85
Regulation of banks' foreign exchange rate	5/14/85
Impact of changing fee structure	5/30/85
Data-management activities	8/28/85
Federal banking agencies' uniform country-risk examination system	9/20/85
Role of credit assurances	10/9/85
Banking risks in new activities	11/19/85
Analysis of government securities market	11/27/85

Table 2.D.2
Completed GAO Reports Related to the Federal Reserve System

Title or subject of report	Number	Date
Comparing Policies and Procedures of the Three Bank Regulatory Agencies	GGD-79-27	3/29/79
Federal Systems Not Designed to Collect Data on All Foreign Investments in U.S. Depository Institutions	GGD-79-42	6/19/79
The Federal Reserve Should Assure Compliance with the 1970 Bank Holding Company Act Amendments	GGD-80-21	3/12/80
Internal Auditing Can Be Strengthened in the Federal Reserve System	GGD-80-59	8/8/80
Despite Positive Effects, Further Foreign Acquisitions of U.S. Banks Should Be Limited until Policy Conflicts Are Fully Addressed	GGD-80-66	8/26/80
Federal Examinations of Financial Institutions: Issues That Need to Be Resolved	GGD-81-12	1/6/81
Examinations of Financial Institutions Do Not Assure Compliance with Consumer Credit Laws	GGD-81-13	1/21/81
Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings	AFMD-81-27	1/23/81
Federal Reserve Security over Currency Transportation Is Adequate	GGD-81-27	2/23/81
The Federal Structure for Examining Financial Institutions Can Be Improved	GGD-81-21	4/24/81
Response to Questions Bearing on the Feasibility of Closing the Federal Reserve Banks	GGD-81-49	5/21/81
Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need for Amendment	GGD-81-80	7/23/81
Federal Reserve Could Improve the Efficiency of Bank Holding Company Inspections	GGD-81-79	8/18/81
Information on Selected Aspects of Federal Reserve System Expenditures	GGD-82-33	2/12/82
Federal Review of Intrastate Branching Can Be Reduced	GGD-82-31	2/24/82
Despite Improvements, Recent Bank Supervision Could Be More Effective and Less Burdensome	GGD-82-21	2/26/82
Issues to Be Considered while Debating Interstate Bank Branching	GGD-82-36	4/9/82
The Federal Reserve Should Move Faster to Eliminate Subsidy of Check Clearing Operations	GGD-82-22	5/7/82
Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes	GGD-82-57	6/1/82
Bank Merger Process Should Be Modernized and Simplified	GGD-82-53	8/16/82
An Analysis of Fiscal and Monetary Policies	PAD-82-45	8/31/82
Bank Examination for Country Risk and International Lending	ID-82-52	9/2/82
Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed	GGD-83-3	10/25/82
Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information	GGD-83-13	8/25/83
Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision	GGD-84-40	2/3/84
Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission	GGD-84-4	2/3/84
Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York	AFMD-84-10	5/2/84
Statutory Requirements for Examining International Banking Institutions Need Attention	GGD-84-39	7/11/84
Supervisory Examinations of International Banking Facilities Need to Be Improved	GGD-84-65	9/20/84
An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check Clearing Activities	GGD-85-9 GGD-85-9A	1/14/85

Chapter 3

Expenses and Budgets of the Federal Reserve Banks

This chapter examines the expenses and budgets of the Federal Reserve Banks. An overview presents total expenses for all the Districts for 1986, including the impact of major initiatives. This is followed by a description of the budgets for the various service lines, long-term trends in expenses and in unit costs and volumes, objects of expense, capital outlays, and the expenses and budgets of each of the 12 Federal Reserve Districts.

Appendixes to this chapter include a general description of the budget process of the Reserve Banks, tables that present additional expense and budget data, a summary of the budget performance of the Banks in 1984 and 1985, and a description of the process for pricing services.

An Overview of the 1986 Budget Year

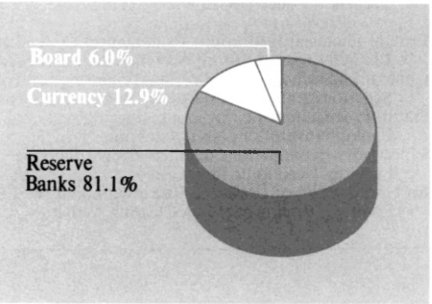
For 1986, the Board of Governors has approved total expenses for the Federal Reserve Banks of $1,182 million, an increase of $62 million, or 5.5 percent, over estimated expenses in 1985.[1] As chart 3.1 shows, this sum accounts for 81 percent of the total expenses for the Federal Reserve System.

Several major initiatives account for the increase in expenses: Board actions announced in 1985 to increase the frequency and scope of Federal Reserve examinations of state member banks and inspections of bank holding companies, and to strengthen the procedures for reporting to bank management; development and implementation of the Treasury Direct-Access Book-Entry System (T-DAB) for individual investors' accounts; a new requirement for notification of the return of large-dollar checks; and Board action to assist small and minority-owned businesses in contracting with the System.

In addition, costs associated with building projects affect the 1986 expenses of certain Districts; these include moves into three new Branch buildings and the renovation of a head office building. Excluding all these special initiatives and one-time costs, total expenses of the Reserve Banks would increase 3.4 percent in 1986. Table 3.1 breaks down the costs of the initiatives and of the building projects and shows how they affect the 1986 budget.

That budget reflects continued ef-

Chart 3.1
Budget for the Federal Reserve Banks, 1986



1. Appendix 3.A describes the budgetmaking process for the Reserve Banks.

Table 3.1
Impact of Major Initiatives and One-Time Costs on the 1986 Budget of the Federal Reserve Banks

Thousands of dollars, except as noted

Item	Dollar amount
1985 estimate	1,120,404
1986 budget	1,182,137
Increase, 1986 from 1985	
Dollar amount	**61,733**
Percent change	**5.5**
ADJUSTMENTS FOR INITIATIVES AND ONE-TIME COSTS	
Increased examination under supervision and regulation	−8,151
T-DAB	−5,435
Notification of return of large-dollar items	−3,993
Small and disadvantaged business procedures [1]	−1,190
One-time costs [2]	
Moves to new buildings	
Los Angeles	−2,522
Jacksonville	−696
Omaha	−663
Move related to renovating building	
Chicago	−1,238
Adjusted increase	
Dollar amount	**37,845**
Percent change	**3.4**

1. For a description of this initiative, see text.
2. Incremental costs include duplicate building depreciation, taxes, and utilities as well as moving expenses.

forts by the Reserve Banks to control costs and to achieve efficiencies by absorbing the impact of expenses for ongoing System initiatives, including the program to reduce daylight overdrafts on networks for large-dollar transfers, the move toward common automation and common communications software, and the System's commitment to encourage electronic payments and to improve the security of electronic networks.

Reserve Bank Expenses by Major Service Line

Table 3.2 and chart 3.2 provide information on aggregate Reserve Bank budgets by service line. Following is a discussion of the major initiatives in 1986.[2]

Monetary and Economic Policy

Expenses by the Federal Reserve Banks for monetary and economic policy total $98 million and account for approximately 8 percent of their 1986 budgets. Expenses increase $4.0 million, or 4.2 percent, from the 1985 estimate. Employment is expected to be the same in 1986 as in 1985, at 813 average number of personnel (ANP).[3]

The increase in expenses reflects primarily growth in salaries and benefits and an increase in resources to implement a banking statistics project. That project will enhance the System's capacity to process and analyze financial data from depository institutions for effective determination and implementation of monetary policy.

Major initiatives reflected in the budget include an expansion of basic research on regional and national issues and on regional economic development, as well as on international economic issues that have implications for U.S. economic growth, the rate of inflation, and the strength of the banking system.

For example, the increase in this area in the budget of the New York Federal Reserve Bank, which accounts for more than one-third of the increase in this area for all the Reserve Banks, includes an additional five ANP for surveillance of government securities dealers and six ANP

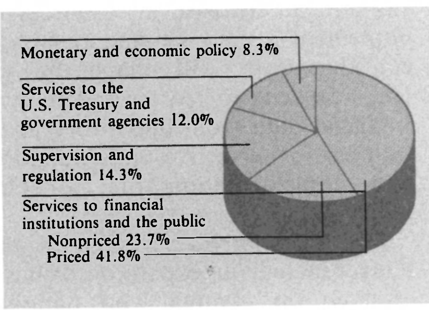
2. See appendix 3.B for details of expenses for each District by service line, and appendixes 3.B and 3.C for the Banks' budget performance.

3. The average number of personnel is the sum of the Banks' employees, adjusted for part-time employees. See chapter 5, note 2, for a more detailed explanation.

Table 3.2
Expenses of the Federal Reserve Banks, by Service Line, 1984–86
Thousands of dollars, except as noted

Service line	1984 Actual	1985 Estimate	1986 Budget	Change, 1985–86	
				Amount	Percent
Monetary and economic policy	99,351.0	93,860.5	97,828.4	3,967.9	4.2
Supervision and regulation	140,690.3	152,007.2	168,570.3	16,563.1	10.9
Services to financial institutions and the public	701,453.0	739,979.0	773,857.2	33,878.2	4.6
Services to U.S. Treasury and government agencies	126,307.3	134,557.2	141,881.0	7,323.8	5.4
Total, all service lines	**1,067,801.7**	**1,120,403.9**	**1,182,136.9**	**61,733.0**	**5.5**

Chart 3.2
Federal Reserve Bank Expenses, by Service Line, 1986



for strengthening research and analysis of foreign capital markets.

Supervision and Regulation

Expenses for supervision and regulation, which total $169 million and constitute 14 percent of the aggregate budgets of the Banks, increase $16.6 million, or 10.9 percent in 1986. Supervision, which includes examination activities, is budgeted to increase 18 percent. A major factor in the Banks' budgets for 1986 is the program for strengthening the supervision of financial institutions by increasing examinations and communications with institutions' directors, which accounts for close to $8.2 million of the increase. Most Banks began to implement the new program in 1985; it is expected to be fully in place by the end of 1987 at a total cost of $9 million.

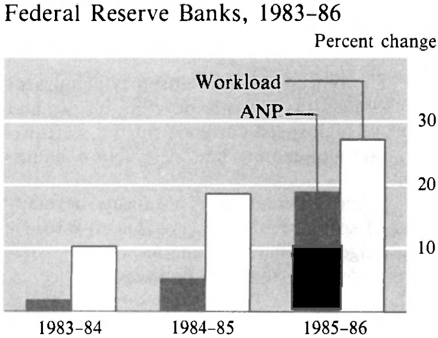
Employment in this area is budgeted to increase 219 ANP, or 11.4 percent; staff increased only 33, or 1.7 percent, in 1985. The new supervisory program accounts for over four-fifths of the total increase. As part of the program the Reserve Banks are introducing extra training and development activities for examiners.

To fund the initiatives, the Board of Governors directed the Banks to reallocate resources, by scaling back when possible in supervisory areas such as examinations for compliance with consumer regulations, trust examinations, and holding company applications, and by shifting in-house analysts to field examinations. Reductions were also made in other areas to fund the examination program. Most Banks plan to improve efficiency through office automation and the exploitation of portable personal computers in the field, less intensive inspections for low-risk institutions, and in-house inspections in certain cases.

Even without the new supervisory initiatives, this service line would be expanding to handle the normal growth in workload that the formation of new state member banks and bank holding companies entails. Estimates of the volume of work at the Reserve Banks indicate a 9 percent increase in the number of commercial bank examinations and a 39 percent increase in bank holding company inspections, half of which is due to the initiatives and half to growth in workload.

Chart 3.3 compares the growth rates for staff and workload in the two largest supervision activities, which are also the activities most affected by the new supervisory initiatives. During 1983 and 1984, the increase in the number of commercial bank examinations and bank holding company inspections completed by the Banks was proportionately far greater than the increases in staff in those areas as Districts tried to control costs and increase productivity and efficiency. In 1985, many Districts began to enlarge their staffs in these activities to meet the continued growth in the workload and to implement the policy initiatives; the growth in the staffs between 1985 and 1986 embodies the System's effort to strengthen supervision. Despite this increase, the growth in staff lags behind the growth in workload from 1983 to 1986.

Chart 3.3
Workload and Employment in Supervision by the Federal Reserve Banks, 1983–86



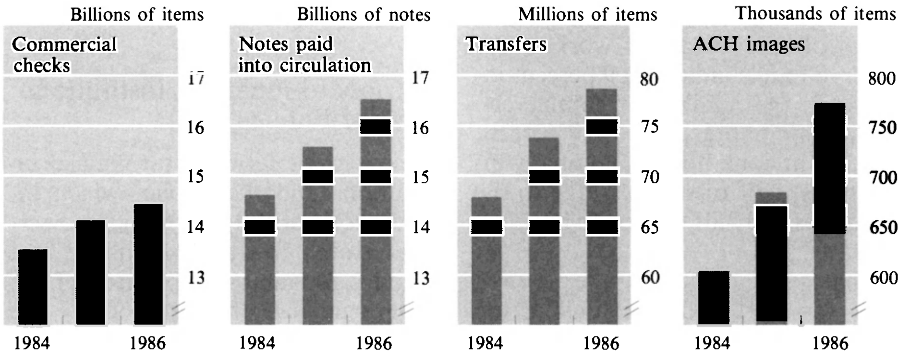
Services to Financial Institutions and the Public

Expenses for services to financial institutions and the public, which include both priced and nonpriced services, total about $774 million and account for almost two-thirds of the 1986 aggregate budget for all the Banks. Expenses are increasing $34 million, or 4.6 percent, down slightly from the 1985 growth rate of 5.5 percent. Volumes are expanding in all the major operations, and employment is budgeted at 8,859 ANP, an increase of 117, or 1.3 percent. Staff increases are attributable to the program of notification of the return of large-dollar checks and to the growth in processing of currency and commercial checks in some Districts.

Chart 3.4 compares expected volumes in various aspects of this service line in 1986 with those of 1985 and 1984. Half of the expenses in this service line are attributable to commercial check processing. The budget increase of $26 million, or 7.2 percent, for this activity accounts for most of the increase for the service line as a whole; growth in volume and initiatives in services and automation are responsible for the increase. In 1986, the System expects to process 14.4 billion commercial checks, 400 million more than in 1985. System initiatives focus on offering new or improved services such as notification of the return of large-dollar checks and truncation;[4] replacement of ob-

4. Truncation is the system under which depository institutions need not return cancelled checks to the writer.

Chart 3.4
Number of Items Processed through the Federal Reserve Banks, by Service Line, 1984–86



solete equipment; expansion and improvement of processing to handle additional volume; and acceleration of funds availability through development of new products and enhancements of existing ones.

Expenses for currency processing constitute 15 percent of the service line's budget and are expected to increase by 2.2 percent. An increase of 2.3 percent in staff is budgeted in response to a rise in volume that results in part from the adoption of the open-access policy and the increased use of ATMs (automated teller machines).[5] High-speed processing of more than 14 billion items is expected next year, an increase of 13.2 percent, and 16.5 billion notes are expected to be paid into circulation. Even with the growth in volume, cost savings have been realized from the phase-down of the currency-equipment development project and from operational changes and implementation of automated cash-processing systems.[6]

Expenses in the funds transfer service are projected to increase by $5 million, or 9.7 percent, largely because of implementation of jointly developed software and expansion of automated networks with financial institutions in several Districts, along with expected growth in volume of 7 percent.[7] The System expects to process 79 million transfers in 1986.

Reductions totaling $500,000 are planned in two services. In the automated clearinghouse (ACH) service, the impact on expenses of continued high growth in volume is more than offset by lower costs associated with jointly developed software. Staff reductions are planned in noncash collection as the growth in volume slows.

5. Open access means that Federal Reserve Banks will offer cash services free of charge to all depository institutions on an equal and impartial basis limited only by the available physical facilities of the Reserve Banks and adherence to the Federal Reserve cash service standards (which specify such things as the size of orders and deposits).

6. The objective of the currency-equipment development project is to develop, install, and improve high-speed currency sorting, verification, authentication, and destruction equipment.

7. In an effort to avoid duplicate development of software, the Reserve Banks, through long-range automation planning, develop software at one site that can be used at other installations. All the Banks share the costs of the development.

Services to the U.S. Treasury and Government Agencies

Expenses for services to the U.S. Treasury and government agencies total $142 million and account for 12 percent of the Banks' aggregate 1986 budget. Expenses show an increase of $7.3 million, or 5.4 percent, over 1985, of which $5.4 million is attributable to the Treasury Direct-Access Book-Entry System (T-DAB), to be implemented in mid-1986.[8] The T-DAB project requires about 125 additional people, mostly in 1986; but the Treasury will be able to reduce its staff approximately 400 as a result of the automation and transfer of this function. Employment in other areas of this service line are budgeted to decline, so that the overall increase from 1985 will be 67, or 3.8 percent.

At least four Banks will participate in the development of a new Treasury tax and loan system; the St. Louis Bank is taking the lead, but the costs are shared by all four Banks. All Districts will be implementing several Treasury mandates in 1986, including the conversion of Treasury checks to fiscal-agency checks and the conversion from card to paper savings bonds.[9]

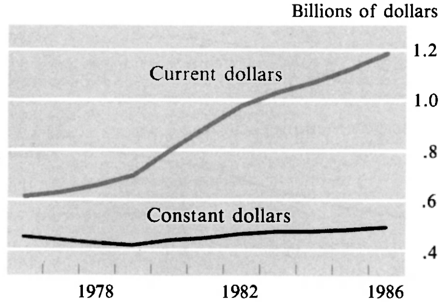
8. These costs, which are reimbursed by the Treasury, are budgeted at all the Reserve Banks. Philadelphia is the central site for T-DAB processing.

9. Fiscal-agency checks are distinctive instruments issued by the Reserve Banks as fiscal agents of the United States for payments in connection with U.S. government securities. Such checks will give the Treasury's Bureau of the Public Debt better control over the payment and claims processes.

As a cost-saving measure, the Treasury is converting Series EE and HH savings bonds from punchcard stock to a lighter-weight, machine-readable paper stock.

Chart 3.5

Total Expenses of the Federal Reserve Banks, 1976–86



Constant dollars are 1972 dollars, deflated with the GNP implict price deflator.

Long-Term Trends in Expenses

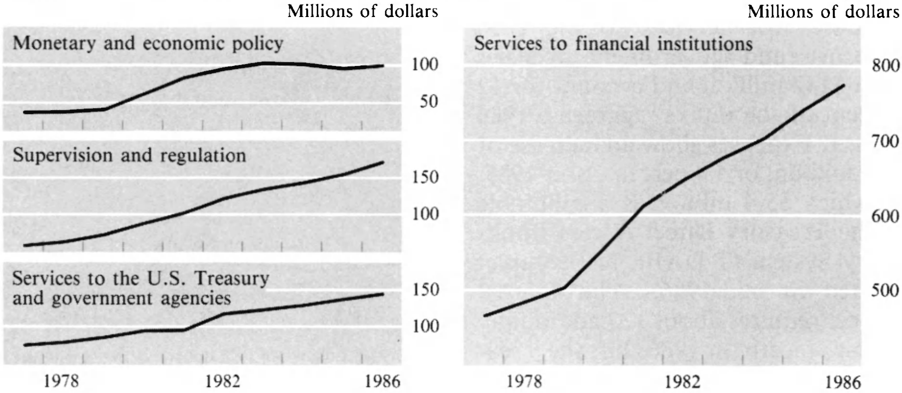
Expenses of the Reserve Banks in current dollars have increased 6.8 percent each year on average for the 10 years ending 1986. In constant dollars, operating expenses have increased only 0.7 percent during this period. As chart 3.5 reveals, expenses have shown an uneven trend during this period. (Chart 3.6 shows the detailed trends in expenses by service line for the same period.[10])

In the first part of the period, the Reserve Banks shifted their emphasis from adding services, through the establishment of regional check-processing centers, to improving efficiency and productivity, through automation and cost restraint. As a result, the average annual growth rate in Reserve Bank expenses from 1976 to 1979 was only 4.4 percent while the rate of inflation averaged 7.3 percent.

In 1980, the Banks had few if any unused resources to redirect toward the requirements that the Monetary Control Act, passed in that year,

10. These data are not available before 1977, the year PACS was instituted. See appendix 3.A for a description of PACS.

Chart 3.6
Expenses of the Federal Reserve Banks, by Service Line, 1977–86



placed on the System. The necessary expansion of resources, coupled with wage increases that were driven by the high rate of inflation during that period, nearly doubled the average annual rate of growth in Reserve Bank expenses to 9.1 percent for 1980–83.[11] As some evidence of the activity generated by the MCA, the number of depository institutions maintaining reserve accounts at the Reserve Banks increased from 6,261 to 9,567, or 53 percent, during 1980–83. In 1983, 134,310 billing entries for priced services were processed.

From 1983 to 1985, the Federal Reserve adjusted to the loss of volume as participants in the payments system responded to the altered competitive environment. Swift actions to reduce expenses so as to meet the MCA requirement to recover fully the costs of providing priced services brought the average annual rate of increase in expenses down to 4.4 percent for 1983–85.

11. See chapter 2 for a description of the general requirements imposed by the Monetary Control Act.

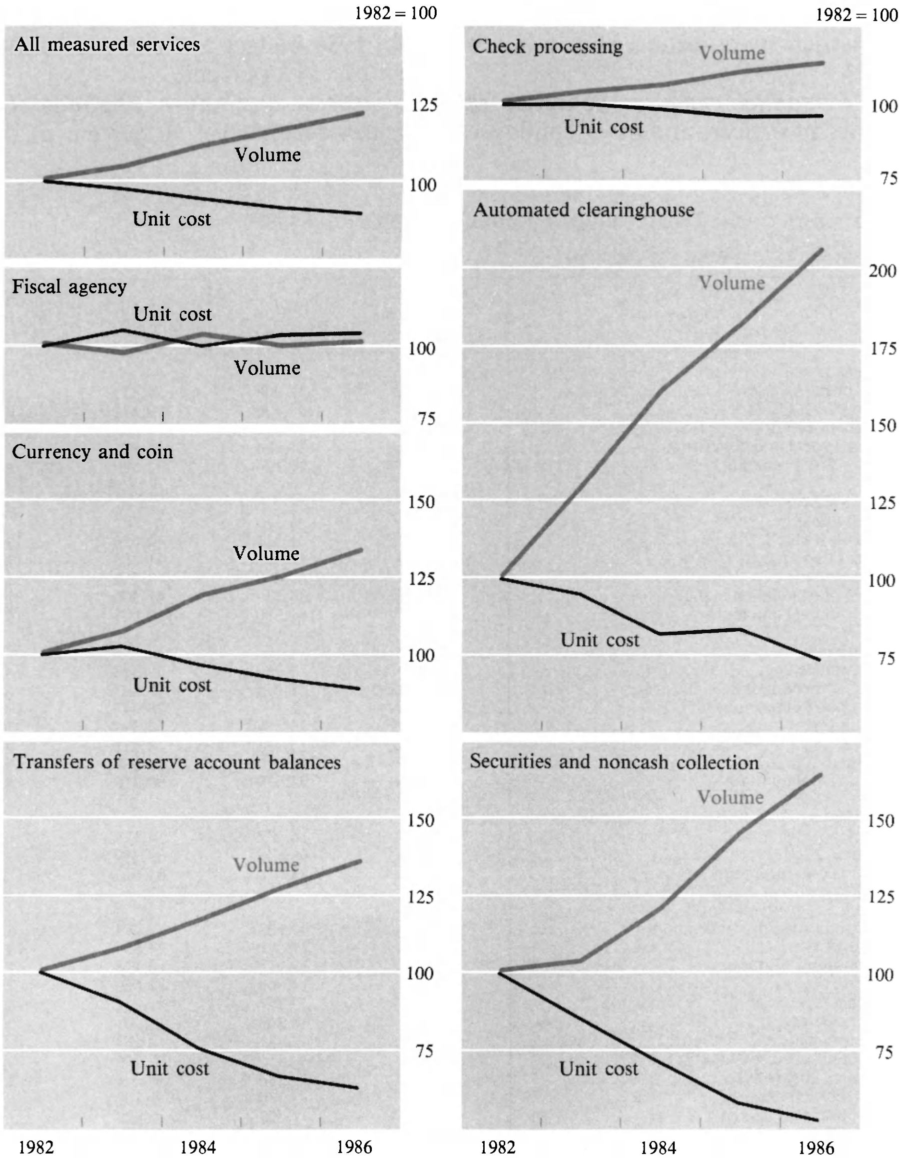
Trends in Volumes and Unit Costs

Chart 3.7 depicts the trends in volumes and unit costs (adjusted for inflation) in the major service operations at the Reserve Banks over the years 1982–86.

The first panel, which plots a composite index of all measured services, indicates that total volume is expected to rise in 1986 about 20 percent above the level in 1982 while unit costs will decline 10 percent below those in 1982. The other panels focus on developments in particular Reserve Bank operations.

Unit cost in fiscal-agency services has fluctuated with the rise and fall of volume but is little changed over the five years. All of the other areas show healthy growth in volume and declining unit cost. Check processing is by far the largest operation and thus has the largest impact on the composite of all services; volume has risen about 13 percent since 1982 while unit cost has declined about 4 percent. This pattern also appears for currency and coin: public demand has

Chart 3.7
Trends in Volume and Unit Cost of Federal Reserve Services, 1982–86



increased almost 30 percent while unit cost has declined more than 10 percent. In transfers of reserve account balances, and in automated clearinghouse, securities, and noncash collection services—services with smaller volumes, which are more automated—the rise in volumes has been much greater and the decline in unit costs more significant.

Objects of Expense

The expenses of the Federal Reserve Districts by object are shown in table 3.3

Personnel expenses comprise salaries of officers and other employees, other personnel expenses, and retirement and other benefits. Total personnel expenses account for 62 percent of the 1986 budget and are expected to increase 4.8 percent.

Salaries and other personnel expenses account for 50 percent of the

Table 3.3

Expenses of the Federal Reserve Banks, by Object, 1984–86

Thousands of dollars, except as noted

Object	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
PERSONNEL				
Officers' salaries	47,126	51,908	54,815	5.6
Employees' salaries	466,077	495,806	529,371	6.8
Other personnel [1]	15,783	15,548	13,505	−13.1
Retirement and benefits	135,503	135,864	134,902	− .7
Total personnel	664,489	699,126	732,593	4.8
NONPERSONNEL				
Equipment				
Purchases	1,852	2,231	2,656	19.0
Rentals	50,534	46,532	41,266	−11.3
Depreciation	51,439	61,408	74,715	21.7
Repairs and maintenance	29,334	34,139	41,306	21.0
Total equipment	133,159	144,310	159,943	10.8
Building				
Insurance	209	282	323	14.5
Taxes on real estate	20,076	21,375	22,807	6.7
Property depreciation	20,588	21,185	23,443	10.7
Utilities	22,992	23,254	24,898	7.1
Rent	12,038	13,231	14,471	9.4
Other	11,993	13,312	14,368	7.9
Total building	87,896	92,639	100,310	8.3
Shipping				
Postage	12,759	14,128	14,177	.3
Other	76,223	68,948	69,439	.7
Total shipping	88,982	83,076	83,616	.7
Other				
Materials, forms, and supplies	41,466	44,633	47,294	6.0
Travel	17,961	21,386	23,558	10.2
Communications	15,266	15,358	16,128	5.0
Fees	13,533	13,968	12,656	− 9.4
Other	34,020	38,852	41,964	8.0
Recoveries	−26,254	−30,363	−33,501	10.3
Contra expenses [2]	− 2,717	− 2,331	− 2,583	10.8
Shared cost distributed [3]	−31,353	−37,456	−35,765	− 4.5
Shared cost received [3]	31,353	37,180	36,205	− 2.6
Support cost distributed [3]	0	0	− 1,107	....
Support cost shared [3]	0	27	828	....
Total other	93,275	101,254	105,677	4.4
Total, all objects	**1,067,801**	**1,120,405**	**1,182,138**	**5.5**

1. Includes expenses for certain contractual arrangements, as well as miscellaneous personnel expenses.

2. Expenses for the production of printed materials and the purchase of furniture and fixtures and building materials in a given period are deducted from the total for the period and, more appropriately, these items are expensed in the period in which they are consumed.

3. These accounts are used to distribute the expenses from the Banks that directly incur them to the Banks that benefit from them. For example, one Bank may incur all the expenses for developing software, which are then distributed to all the Banks that use that software.

Banks' budgeted expenses and are expected to increase about $34 million, or 6.1 percent, in 1986 to $598 million. Salaries are expected to increase 6.7 percent while other personnel expenses will decline 13.1 percent.

Each Federal Reserve office bases its salary structure on surveys of what major employers in its community pay for comparable positions. These surveys are conducted each year to determine whether an adjustment to the structure is warranted. The Federal Reserve Bank relies on nationwide surveys to adjust the structure of officers' salaries.

Expenses for retirement and other benefits, which account for 12 percent of the Banks' budgeted expenses, are projected to fall $1.0 million, or 0.7 percent, from 1985. This decrease reflects a decline in contributions to the retirement plan partly offset by increases in social security, workmen's compensation, unemployment insurance, group life insurance, the thrift plan, and hospital and medical expenses.[12]

Nonpersonnel expenses account for 38 percent of the Banks' expenses and are increasing 6.3 percent.

Equipment costs account for 14 percent of total expenses and are budgeted to increase 10.8 percent. The increase results from shifts to equipment compatible with the System's long-range automation plan and with automation and communications standards; upgrading, replacement, and reconfiguration of check equipment in order to provide better service; replacement of obsolete return-item equipment that vendors will no longer maintain; continued implementation of office automation systems; encryption of communication links; and purchase of personal computers used in communication networks with financial institutions.

Building expenses, which constitute 8 percent of total expenses, are expected to increase 8.3 percent, reflecting increases in local tax rates and assessments, increases in utility rates and consumption, renovations and refurbishments, and higher rentals in some Districts. Offsetting these increases will be a minor reduction in "other building expenses" at several Districts as a result of reductions in outside contracting and the completion of one-time projects in 1985.

Shipping costs, which are 7 percent of total expenses, are budgeted to increase only 0.7 percent in 1986, held down primarily by the discontinuation of the cash transportation service in the Dallas District. Most of the increase is for additional courier stops and relays and for anticipated rate increases in renegotiated courier contracts.

Other expenses are expected to increase $4.4 million, or 4.4 percent, primarily reflecting increases in materials, forms, and supplies ($2.7 million); travel ($2.2 million); and "other" ($3.1 million). The increases in the last two categories are attributable largely to the supervision and

12. The Reserve Bank retirement plan is a noncontributory plan integrated with social security; it utilizes a formula based on length of service and the average salary of the five highest consecutive years. Normal retirement is at age 65, vesting is at 10 years of service, and death benefits are provided. Hospital and medical plans are negotiated separately by each District office; all plans require the employee to share in the costs, and all plans have acted to contain costs in the last few years. The thrift plan is a voluntary savings and investment program in which an employee may participate after six months' service. The Banks contribute a percentage of the employee's contribution up to the first 6 percent of salary. Vesting of employer contributions is based on years of participation with full vesting at five years.

regulation program and to training and education programs. These increases are partially offset by an increase in recoveries from the rental of excess office space and the leasing of terminals to depository institutions.

Capital Outlays

Table 3.4 shows the plans of the Reserve Banks for capital spending in 1986. Capital outlays are budgeted at $231.4 million, an increase of $59.6 million, or 34.7 percent, over 1985.

The largest single share of capital expenditures in 1986 (44.8 percent, or $103.8 million) is for *buildings.* These expenditures include $35.2 million at the Federal Reserve Bank of Chicago, mainly for renovation and expansion of facilities; $30.9 million at the Federal Reserve Bank of San Francisco to complete the new building for the Los Angeles Branch; $20.2 million at the Federal Reserve Bank of New York for a contingency center for computer support; and $4.9 million at Atlanta, mainly for an addition to the head office building.

The second major category of capital expenditure is *data processing–data communication* equipment ($91.9 million, 39.7 percent of the total). These expenditures include $11.3 million at the Federal Reserve Bank of Chicago, mainly for processors, controllers, encryption devices, a node of the Federal Reserve's advanced communications system (FRCS 80), replacement of obsolete equipment, and the purchase of equipment currently leased; $14.5 million at Atlanta for upgrading the computer and the purchase of currently leased reader-sorters for check processing; $13.7 million at San Francisco, mainly for upgrading the computer and peripheral equipment and for conversion of equipment in low-speed check operations; and $13.2 million at New York, reflecting upgrades to the Bank's general operating computers and peripherals, equipment for Fedwire, and replacement of the telephone system to afford voice and data transmission capability. Also at New York, $5.0 million has been budgeted for *land and other real estate* associated with the contingency back-up center.

Purchases of *furniture and other equipment* are budgeted at $22.2 million. Within this total, expenditures for *furniture and other furnishings* are expected to be $10.1 million, mostly for smaller items in connection with renovations. Of the $12.2 million for *other equipment,* the larger expenditures are $2.5 million at

Table 3.4

Capital Outlays of the Federal Reserve Banks, by Capital Class, 1984–86

Thousands of dollars, except as noted

Class	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Data processing and data communication equipment	44,781	81,925	91,876	12.1
Furniture and other equipment	14,137	21,256	22,244	4.6
Land and other real estate	1,641	1,975	5,221	164.4
Buildings	23,724	59,445	103,760	74.5
Building machinery and equipment	3,082	6,132	7,328	19.5
Leasehold improvements	1,355	1,028	955	−7.1
Total, all classes	**88,720**	**171,761**	**231,382**	**34.7**

New York for equipment for packaging currency and for other, smaller items; $1.6 million at Atlanta, half of which is for the new building for the Jacksonville Branch; $1.3 million at Kansas City, of which the largest single portion is for exhibits for the renovated lobby and balcony of the head office building; $1.3 million at San Francisco, of which the largest single portion is for a briquetting machine for the residue from destroying worn currency and food stamps; and $800,000 at Philadelphia.

Expenditures for *building machinery and equipment* are budgeted at $7.3 million and are mainly for long-lived equipment: Cleveland will spend $2.0 million, mostly for maintenance of elevators and a pumping system; Kansas City, $1.2 million, mostly for an automated security and energy management system and plumbing and mechanical work; Dallas, $1.1 million, mainly for electrical chiller drives and replacement of the cooling tower; and San Francisco, $900,000, mostly for emergency power equipment.

Expenditures for *leasehold improvements* total $1.0 million and are mostly at San Francisco for tenant improvements ($400,000), at Chicago for warehouse improvements ($200,000), and at New York for an elevator at the Cranford regional check-processing center ($100,000).

Expenses by District

All Federal Reserve Banks provide principally the same services in their District territories and contribute similarly to the central bank functions of the System. However, differences in the size of their Districts and in other conditions cause variations in the budget and expected growth in expenses among the Banks. Table 3.5 lists the Branches and offices and regional check-processing centers in the District territories. Table 3.6 offers information on the total expenses for each Reserve District for the years 1984, 1985, and 1986. A description of the major initiatives affecting the Districts' budgets follows.

Boston

Boston plans expenses totaling $69.3 million in 1986, an increase over 1985 of $2.9 million, or 4.4 percent.

The Boston Bank has been heavily involved in conversion to System automation standards, including upgrading mainframe computers and implementing the commonly developed System software. In 1986, this initiative will continue; however, slightly fewer resources are expected to be devoted to it than in previous years.

In 1986, the Bank is planning to build electronic connections with financial institutions to provide better electronic services. Also affecting expenses is the tight labor market in the New England area and the need to maintain competitive salaries, especially in computer services. The Boston budget was not significantly affected by the Board's enhancement of the examination program because the District has few state member banks. Projections of the volume of priced services show growth moderating in 1986 from 1985.

New York

The New York Bank's budgeted expenses are $225 million in 1986, an increase of $6.4 million, or 2.9 percent, over 1985. The total represents significant savings from implementing the recommendations of a study of the Bank's cost structure that was spurred

Table 3.5
Offices and Branches, and Regional Check-Processing Centers of the Federal Reserve Districts

District	Branch or office	RCPC
Boston	....	Lewiston, ME Windsor Locks, CT
New York	Buffalo, NY	Cranford, NJ Jericho, NY Utica, NY
Philadelphia	....	....
Cleveland	Cincinnati, OH Pittsburgh, PA	Columbus, OH
Richmond	Baltimore, MD Charlotte, NC Culpeper (VA) Communications and Records Center	Columbia, SC Charleston, WV
Atlanta	Birmingham, AL Jacksonville, FL Miami, FL Nashville, TN New Orleans, LA	....
Chicago	Detroit, MI	Des Moines, IA Indianapolis, IN Milwaukee, WI
St. Louis	Little Rock, AR Louisville, KY Memphis, TN	....
Minneapolis	Helena, MT	....
Kansas City	Denver, CO Oklahoma City, OK Omaha, NE	....
Dallas	El Paso, TX Houston, TX San Antonio, TX	....
San Francisco	Los Angeles, CA Portland, OR Salt Lake City, UT Seattle, WA	....

by declining growth in volume and low cost recovery in check services over the past few years. The 1986 budget embodies savings from closing one of the two head office cafeterias, from the early release of leased computer equipment, and from reductions in staff in support and overhead functions. The establishment of a contingency computer site is also expected to produce long-run savings. Offsetting part of these savings will be the resources for strengthening the Bank's supervisory initiatives. In 1986, these include improving the public's understanding of new financial instruments and markets and tightening the guidelines for banks' off-balance-sheet activities and international funding and trading practices.

Philadelphia

Philadelphia's 1986 budget is $67 million, an increase in expenses of $4.8 million, or 7.8 percent. This

Table 3.6
Total Expenses of the Federal Reserve Banks, by District, 1984–86
Thousands of dollars, except as noted

District	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Boston	64,410	66,347	69,292	4.4
New York	217,503	218,941	225,328	2.9
Philadelphia	55,371	61,942	66,766	7.8
Cleveland	60,870	65,351	69,929	7.0
Richmond	81,804	88,280	92,057	4.3
Atlanta	94,577	100,732	107,318	6.5
Chicago	131,009	133,576	141,121	5.6
St. Louis	54,505	56,506	59,533	5.4
Minneapolis	53,599	55,660	57,988	4.2
Kansas City	68,434	71,374	76,284	6.9
Dallas	65,246	72,277	76,639	6.0
San Francisco	120,473	129,419	139,882	8.1
Total, all Districts	**1,067,801**	**1,120,405**	**1,182,137**	**5.5**

sizable increase is attributable to the Bank's development and operation of the T-DAB system on behalf of the Treasury for the System, whose cost rises $2 million in 1986 from 1985. The T-DAB system is expected to cost $9 million in total, which will be fully reimbursed by the Treasury. Excluding T-DAB, the Bank's budget would increase 4.5 percent over 1985.

The Bank's major initiative in 1986 involves several aspects of automation: implementing the jointly developed software, upgrading the mainframe to meet the demands of these software applications, and accommodating the System network architecture (SNA).[13]

For 1986, the District expects normal growth in volume in most services, except definitive safekeeping, whose volume is expected to increase more than usual.

Cleveland

Cleveland has budgeted expenses of $69.9 million in 1986, an increase of $4.6 million, or 7.0 percent, over 1985. The increase is due largely to an expansion in the supervision staff to handle the larger number of examinations and to plans for a comprehensive management-information system to support supervision activities. Work on improving the District's automation in 1986 involves upgrading the check processors at three locations. Additional disk storage is planned in conjunction with housing an increase in software applications on the mainframe. Two Branches will purchase processors for office automation networks.

Richmond

Richmond's budgeted expenses for 1986 total $92.1 million, an increase of $3.8 million, or 4.3 percent. The Bank expended substantially more resources than expected in 1985 to respond to the crisis in Maryland's thrift industry as well as to handle increases in the volume of check collection, funds transfers, ACH, and noncash collection services that were larger than it had budgeted for.

13. SNA is a common format for exchanging data between depository institutions and the Federal Reserve Banks.

The Bank's budget reflects the increase in examinations and inspections and plans to upgrade computers, expand communication links with financial institutions, continue with office automation, and participate in the System's pilot program of check truncation. The District is expecting somewhat slower growth in the volume of services in 1986, particularly in check processing. The District will also proceed with plans for a new building at the Charlotte Branch, whose design the Board has approved.

Atlanta

The Atlanta Bank's budget for 1986 is $107.3 million, an increase of $6.6 million, or 6.5 percent, over 1985.

The Bank faces several high-priority initiatives in 1986: meeting tightened examination and inspection guidelines, responding to large and rapidly growing volumes of services, and completing its five-year conversion to System automation standards and to the Systemwide jointly developed software. The District also plans large capital investments in computers and communication equipment. It will complete a new building in Jacksonville in mid-1986.

Additions and renovations to the Bank's head office are planned to house additional staff and to provide better meeting space. In the meantime, the Bank will lease space to accommodate the additional bank examiners hired in 1985 and 1986.

Chicago

The Chicago District has budgeted total expenses of $141.1 million for 1986, an increase of $7.5 million, or 5.6 percent, over 1985. In 1984, facing the long-term prospect of declining volumes in services and high costs, the District reduced staff by 200 ANP. Expenses increased only 0.9 percent in 1984 and 2 percent in 1985. Over 30 percent of the increase in expenses in 1986 results from adding 36 ANP to supervision to handle a projected 120 percent increase in workload related to bank holding company inspections. This increase is part of the Bank's response to the Board's effort to strengthen the supervision of financial institutions.

In addition, in 1986 renovation will begin on the 60-year-old Bank building; preparations for the renovation work will incur significant operating costs.

The District will also be involved in installing several pieces of the jointly developed software in 1986 and a new communications network to provide better electronic services.

St. Louis

The budgeted expenses of the St. Louis District are $59.5 million. The increase of $3.0 million, or 5.4 percent, over 1985 is due largely to an increase in staff of 55 ANP. The volume of priced services has begun to increase, as have acitivities in the supervisory area and the installation of jointly developed software. To mitigate the effect of the increase in staff, the Bank has planned one of the smallest merit increases in pay: it will average 4.0 percent for officers and other employees.

The St. Louis District generally performs a comparatively low volume of services, and it expects that volume in the key check service will decline in 1986. Full cost recovery is still planned, however. In supervision, the number of bank holding company inspections is expected to rise from 68 in 1982 to 460 in 1986.

Minneapolis

The Minneapolis District plans a 1986 budget of $58 million, $2.3 million, or 4.2 percent, more than in 1985. This comparatively small increase reflects the Bank's continuing efforts at cost control. As the smallest District, with a low volume of services, the District has felt a disproportionately heavy impact on expenses from the System's standardization of automation. Outside of the San Francisco District, which includes Alaska and Hawaii, this is also the largest District geographically, a condition that restricts the Bank's ability to provide services at a low cost. To improve its recovery of the costs of priced services, the District has already reduced staff and is budgeting another reduction in 1986. Another cost-saving measure is the District's postponement of the purchase of a large-scale computer until 1987.

The Bank's supervisory responsibilities have increased significantly as a result of problems the District's agricultural sector faces. To meet the growing workload, the District has implemented automation that will increase productivity and has reallocated staff from other supervisory efforts.

Kansas City

The 1986 budget of the Kansas City District totals $76.3 million, an increase of $4.9 million, or 6.9 percent, from 1985. An increasing workload imposed by the growth in the number of holding companies and the condition of institutions in the agricultural and energy sectors requires the Bank to continue to allocate large amounts of resources to supervision. (This District has the greatest number of institutions to examine or inspect and has experienced more bank failures than any other.) An additional 64 positions are planned over the period 1985–87, with a 1986 budget impact of over $1 million.

Another major initiative will be the move into the new Omaha Branch building scheduled for early 1986. Total construction costs of $16.1 million are expected to be below the approved budget. The District's budget also includes a multiyear renovation of the head office building, which will be essentially completed in 1986. In addition, the District will expand and improve the electronic delivery of services to financial institutions and will implement the jointly developed software in accounting and statistics in 1986.

Dallas

The Dallas District's 1986 budget totals $76.6 million, an increase of $4.4 million, or 6.0 percent, over 1985.

The Dallas District has experienced very rapid growth in the volume of check and currency services and in the number of financial institutions to be supervised. In 1985, the number of commercial checks processed increased 7 percent; and in 1986, it is expected to increase another 6 percent. An expanding population lies behind this growth, as do new services. For example, the San Antonio branch began processing large volumes of checks from the Internal Revenue Service in the spring of 1985. Expenses and staff have increased in this area with the plans for additional sorter equipment and for upgrading equipment. To avoid backlogs in handling currency, additional work shifts have been assigned to the high-speed processing equipment, with a resulting increase in staff.

Coupled with this large growth in volume is the District's special challenge in the supervisory area, posed by adverse developments in energy and real estate lending. The District has established a special monitoring unit to handle these problems. At the same time, the number of organizations supervised by Dallas continues to grow. The District projects 141 more examinations and inspections in 1986 than in 1985, a 56 percent increase. Because of the expansion of staff in this area, the District needs to lease additional space in downtown Dallas.

San Francisco

The San Francisco District's 1986 budget is $139.9 million, an increase from 1985 of $10.5 million, or 8.1 percent. Part of the growth in expenses results from nonrecurring costs associated with the move of the Los Angeles Branch to a new building, scheduled for the fall of 1986. Excluding the costs associated with the move, District expenses will rise $8.6 million, or 6.6 percent, from 1985. In addition, the public's demand for currency in the Los Angeles and San Francisco offices has grown substantially. This growth began in the second quarter of 1984 and has caused large backlogs. The District has responded by scheduling more overtime work, shipping notes to other offices, and adding work shifts.

The District is also expanding its staff to accommodate rapid growth in the volumes of check processing and funds transfers.

Another factor affecting expenses and staff is the District's strengthening of the examination and inspection function. The number of commercial bank examinations is expected to be 88 in 1986 compared with 72 in 1985, and bank holding inspections will total 248 compared with 159. The District will add 33 ANP to respond to this increase in its workload, strengthen inspection procedures, increase periodic monitoring of large and complex organizations, and process reports.

Appendix 3.A

The Budget and Control Process of the Federal Reserve Banks

The Federal Reserve Banks use an annual, calendar-year planning, budget, and control process. The planning process includes strategic planning and short-term tactical planning at both the System level and the Bank level, which identifies major goals, objectives, and strategies. The budget process includes the identification, review, and approval of resources needed to achieve goals and objectives. The control process includes the comparison of results against goals and objectives and the comparison of financial performance against the approved budget.

The Planning and Control System

In 1977, the Federal Reserve Banks implemented a new accounting and budgeting system, the Planning and Control System (PACS), which provides a more effective review of expenses, an expense audit "trail," and expense accountability. PACS is a system of uniform expense accounting, cost accounting, and reporting that enables the Board of Governors to compare the financial performance of the Reserve Banks and facilitates the aggregation of expenses across the Reserve Banks and Branches. PACS also serves the control function by allowing comparisons of performance against budget for specific objects and activities (see appendix 3.C).

PACS identifies accounts—such as officers' salaries—in detail. In addition, costs are accumulated by major function, the largest of which are the four primary service lines described in detail in chapter 2: (1) monetary and economic policy; (2) supervision and regulation of financial institutions; (3) services to financial institutions and the public; and (4) services to the U.S. Treasury and other government agencies. All support and overhead costs are fully distributed or allocated to these four service lines.

PACS provides productivity statistics (primarily unit costs and items per manhour), environmental statistics (to clarify the differences between Banks' operating environments), and quality statistics. PACS also allows for separate accounting and reporting of costs for projects outside routine activities and services. It serves as the fundamental cost accounting system for all the services the Federal Reserve Banks provide, whether priced or nonpriced.

Periodic audits by the Board through on-site operations reviews have affirmed compliance by the Reserve Banks with the PACS instructions. Similarly, independent examinations—by the General Accounting Office and by an outside public accounting firm—have determined that PACS is an appropriate and effective accounting mechanism for the Federal Reserve. Several agencies have studied its design for their own use.[14]

14. See Comptroller General of the United States, Report to the Chairman, Senate Committee on Banking, Housing, and Urban Affairs, *An Examination of Concerns Expressed*

The Budget Process

At the beginning of each calendar year, budget planning begins with the development by the Board and Bank staff and approval by the Board of guidelines based on forecasts of changes in workload and productivity for the coming budget year. The annual budget objective includes these guidelines and is used by the Reserve Banks in developing plans and budgets. In addition, the Banks develop a strategic directional statement covering three years to guide financial management and development of their priced-service business. In the spring, the Banks develop their own goals, objectives, and strategies and begin their budget process.

The management of each Bank department budgets for nearly all expenses. They are expected, whenever possible, to use a zero-base procedure, especially for travel, training, and the like. During the summer senior Bank officials review departmental requests and the First Vice President and President make the final decisions. The Bank's Board of Directors then reviews and approves the budget, and in the fall the Board of Governors reviews and approves fee schedules for priced services and the Reserve Bank budgets.

Setting Objectives

Each year the Board of Governors formally approves a guideline for the budget expenses of nonpriced services, in the form of a percentage increase over the level in the current year. The process begins early in the calendar year, when an advisory group is formed under the Conference of First Vice Presidents to recommend basic budget assumptions for the upcoming year to the Conference (and ultimately to the Board of Governors). The Budget Objective Advisory Group makes economic assumptions for the budget year and assesses legislation and other factors that may affect the System's responsibilities. An aggregate expense guideline is established for the total of all central bank services and nonpriced Treasury services; and the cost recovery objective for priced services is affirmed. The advisory group's recommendation is forwarded to the Conference of Presidents and the Conference of First Vice Presidents before submission to the Board.[15]

After thorough consideration, the Board's Committee on Reserve Bank Activities makes recommendations to the Board, which reviews the assumptions and approves a budget objective in an open meeting. The budget objective is then sent to the Reserve Banks and serves as their overall management guide in formulating their budgets. The budget objective helps ensure that financial planning among the Reserve Banks is consistent. When the Board reviews and approves the Banks' budgets, it carefully compares them with the budget objective.

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about the Federal Reserve's Pricing of Check Clearing Activities, January 14, 1985; and Arthur Andersen & Co., *Federal Reserve System: Report on Priced Services Activities.*

15. The Conference of First Vice Presidents comprises the first vice president from each Reserve Bank, who is the chief operating officer and is responsible for day-to-day management of the District Bank.

The Advisory Group on Budgets is made up of senior Bank officers and a Board officer.

The Conference of Presidents comprises the president from each Reserve Bank.

Budgeting for System Projects

Certain expenditures of the Reserve Banks are associated with research and development projects that benefit the entire System; therefore, all Districts must bear a share of the costs. Budgets must be prepared and approved for these costs so that each Reserve Bank can include its share in its annual budget.

Budgets for such projects are reviewed by committees of the Conference of First Vice Presidents, Board staff, and other responsible System groups. After these reviews are completed, the budgets are approved by the Conference of First Vice Presidents and the allocated costs forwarded to the individual Reserve Banks for inclusion in their respective budgets. This process occurs between March and July of each year and affords an extra level of scrutiny on significant projects under way in the System.

The Capital Budget Process

The Reserve Banks' planning, budgeting, and control process includes the preparation, review, and approval of capital outlay schedules. Each year the Banks evaluate their needs for buildings, furniture, furnishings and fixtures, land, and automation equipment. In accordance with generally accepted accounting principles (GAAP), depreciation of capital assets is included in the expenses of the Banks. All large capital expenditures receive a thorough review separate from the actual planning, budgeting, and control process. Acquisitions of mainframe computers and peripheral equipment, at certain dollar levels, must be individually approved by the Board of Governors.

The Board has established detailed, comprehensive guidelines for preparation of proposals for the purchase of capital assets. For a new building program, these guidelines, which appear in the *Facilities Planning Manual,* are exhaustive. Furthermore, the Board must approve each new building project at various stages of construction. In the automation area, the Board sets out automation procurement guidelines for proposals to acquire equipment.

Technical staff at the Board review all capital proposals and make recommendations to the Director of the Division of Federal Reserve Bank Operations or to the Board of Governors, depending on the level of approval required.

The Budget Review Process at the Board of Governors

Reserve Bank budgets are forwarded to the Board in the fall. Analysts at the Board review the budgets and note significant Systemwide issues to be addressed during the budget review. The narrative justification of the budget data, particularly the executive summaries and the statements of objectives, are analyzed in terms of the Bank's own trend in past years, of the level of increase in a specific area compared with those of other Districts, and of compliance with the System budget objective and cost-recovery objectives for priced services.

Also, the Product Directors, the Pricing Policy Committee, and the Board review the Reserve Bank budgets for priced services. This combined review accomplishes the integration of priced-services and budget reviews into an overall review of Bank objectives. The various reviews yield issues and questions, and the most important issues become the agenda for the meetings held in the fall with each Reserve Bank President and the Committee on Federal Reserve Bank Activities (consisting of three Governors).

Board Approval

When the Committee on Federal Reserve Bank Activities is satisfied with each Reserve Bank's budget, these budgets are sent to the Board of Governors for approval. Budgets are reviewed and approved at an open meeting of the Board of Governors. Subsequently, a letter is sent to each Reserve Bank President stating the budget level approved by the Board and any conditions placed on this level.

The Monitoring and Control Process

District expenses are monitored and controlled at both the Reserve Banks and the Board of Governors. The Reserve Banks are permitted flexibility to move approved levels of spending within expense and service structures; however, the Board guidelines require notification of significant reallocations of approved budget levels. Careful monitoring minimizes overruns and increases flexibility by permitting transfers.

Results of the 1986 Budget Review

The 1986 budget reflects the comprehensive review of departmental requests at the Reserve Bank level and a thorough review of each District's budget and business plan by the Board's staff and by the Committee on Federal Reserve Bank Activities. Significant cuts were made to departmental requests before their submission to the Board, reflecting the postponement of initiatives, delays in acquiring equipment, and general savings targets. In addition, several Reserve Banks were able to reduce budgeted requests further after the Board review. These reductions reflect the commitment by the Reserve Banks to hold expense growth to a

Table 3.A.1

Reductions to Budgets of Federal Reserve Banks, 1986 Budget

Millions of dollars

District	Source of reduction			Total, all sources
	Internal Bank review	Board review	Changes in benefits	
Boston	2.6	0	2.9	5.5
New York	2.2	.9	4.1	7.2
Philadelphia	.2	.1	.6	.9
Cleveland	.6	0	.9	1.5
Richmond	.2	0	.6	.8
Atlanta	0	1.0	1.4	2.4
Chicago	1.9	0	2.4	4.3
St. Louis	0	0	.3	.3
Minneapolis	1.5	0	1.7	3.2
Kansas City	.2	0	.6	.8
Dallas	1.5	.9	2.7	5.1
San Francisco	6.0	1.7	8.4	16.1
Total, all Districts	**16.9**	**4.6**	**26.5**	48.0

minimum while meeting Board mandates. These reductions, coupled with the effect of certain proposals to change benefits recently approved by the Board, cut the Banks' preliminary budget increase from 6.4 percent to 5.5 percent. Table 3.A.1 presents the reductions from each source by District.

Appendix 3.B

Expenses and Budgets of the Federal Reserve Banks, 1985 and 1986

This appendix presents detailed tables of the expenses and budgets of the Federal Reserve Banks for 1985 and 1986.

Table 3.B.1

Expenses of the Federal Reserve Banks for Monetary and Economic Policy, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985-86	
			Amount	Percent
Boston	5,834	6,272	438	7.5
New York	30,087[1]	31,577[1]	1,490	5.0
Philadelphia	5,321	4,766	−555	−10.4
Cleveland	4,279	4,723	444	10.4
Richmond	4,378	4,791	413	9.4
Atlanta	7,287	7,232	− 55	− .7
Chicago	8,069	8,595	526	6.5
St. Louis	4,882	4,995	113	2.3
Minneapolis	3,958	4,546	588	14.9
Kansas City	5,220	5,316	96	1.8
Dallas	5,109	5,667	558	10.9
San Francisco	9,438	9,348	− 90	− .9
Total, all Districts	**93,862**	**97,828**	**3,966**	**4.2**

1. Data for the New York District include the expenses of the open market trading service, which is unique to New York, estimated at $10.8 million in 1985 and at $11.5 million in 1986.

Table 3.B.2

Expenses of the Federal Reserve Banks for Supervision and Regulation, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985-86	
			Amount	Percent
Boston	7,741	8,247	506	6.5
New York	29,795	31,420	1,625	5.5
Philadelphia	7,596	7,652	56	.7
Cleveland	8,148	10,161	2,013	24.7
Richmond	9,626	10,285	659	6.8
Atlanta	12,019	13,788	1,769	14.7
Chicago	21,441	24,921	3,480	16.2
St. Louis	6,791	7,294	503	7.4
Minneapolis	8,012	8,439	427	5.3
Kansas City	12,513	14,503	1,990	15.9
Dallas	11,047	12,554	1,507	13.6
San Francisco	17,280	19,303	2,023	11.7
Total, all Districts	**152,009**	**168,570**	**16,561**	**10.9**

Table 3.B.3

Expenses of the Federal Reserve Banks
for Services to Financial Institutions and the Public, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985-86	
			Amount	Percent
Boston	45,822	47,465	1,643	3.6
New York	128,475	130,557	2,082	1.6
Philadelphia	35,147	37,949	2,802	8.0
Cleveland	44,218	46,100	1,882	4.3
Richmond	65,576	67,916	2,340	3.6
Atlanta	72,269	76,553	4,284	5.9
Chicago	88,086	91,235	3,149	3.6
St. Louis	37,352	39,428	2,076	5.6
Minneapolis	39,556	40,696	1,140	2.9
Kansas City	46,726	49,306	2,580	5.5
Dallas	49,478	51,453	1,975	4.0
San Francisco	87,275	95,199	7,924	9.1
Total, all Districts	**739,980**	**773,857**	**33,877**	**4.6**

Table 3.B.4

Expenses of the Federal Reserve Banks
for Services to U.S. Treasury and Government Agencies, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985-86	
			Amount	Percent
Boston	6,951	7,308	357	5.1
New York	30,584	31,775	1,191	3.9
Philadelphia	13,879	16,399	2,520[1]	18.2
Cleveland	8,705	8,945	240	2.8
Richmond	8,700	9,066	366	4.2
Atlanta	9,158	9,745	587	6.4
Chicago	15,980	16,372	392	2.5
St. Louis	7,481	7,816	335	4.5
Minneapolis	4,135	4,306	171	4.1
Kansas City	6,915	7,159	244	3.5
Dallas	6,643	6,965	322	4.8
San Francisco	15,426	16,032	606	3.9
Total, all Districts	**134,557**	**141,881**	**7,324**	**5.4**

1. Includes the expenses for T-DAB, which the Treasury will reimburse (see text).

Table 3.B.5

Expenses of the Federal Reserve Banks
for Central Bank and Treasury Services, by District, 1985 and 1986[1]

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985–86		
			Amount	Percent	
				Unadjusted	After adjustment for shift of book-entry service[2]
Boston	37,144.3	38,857.2	1,712.9	4.6	3.2
New York	147,055.9	155,106.7	8,050.8	5.5	2.7
Philadelphia	41,331.9	44,023.6	2,691.7	6.5	5.1
Cleveland	35,797.9	38,745.3	2,947.4	8.2	6.9
Richmond	48,922.0	50,893.4	1,971.4	4.0	3.1
Atlanta	51,286.7	55,118.9	3,832.2	7.5	6.2
Chicago	69,794.0	75,769.3	5,975.3	8.6	7.3
St. Louis	34,464.2	35,842.2	1,378.0	4.0	3.2
Minneapolis	25,170.0	27,414.4	2,244.4	8.9	5.9
Kansas City	38,926.6	42,131.3	3,204.7	8.2	7.5
Dallas	37,400.0	40,515.9	3,115.9	8.3	7.5
San Francisco	76,708.3	83,665.0	6,956.7	9.1	7.4
Total, all Districts	**644,001.8**	**688,083.2**	**44,081.4**	**6.8**	**5.1**

1. Includes direct, support, and overhead expenses charged to monetary and economic policy, supervision and regulation, nonpriced services to financial institutions and the public, and services to the U.S. Treasury and government agencies.

2. The movement of the Treasury book-entry service from a priced to a nonpriced service in October 1985 shifted expenses into central bank and Treasury services.

Table 3.B.6

Expenses of the Federal Reserve Banks
for Salaries of Officers and Employees, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985–86	
			Amount	Percent
Boston	36,366.4	38,117.8	1,751.4	4.8
New York	111,655.0	116,653.5	4,998.5	4.5
Philadelphia	27,551.9	30,763.5	3,211.6	11.7[1]
Cleveland	31,132.5	33,321.3	2,188.8	7.0
Richmond	41,104.3	43,646.4	2,542.1	6.2
Atlanta	47,269.7	50,543.3	3,273.6	6.9
Chicago	67,208.0	71,829.2	4,621.2	6.9
St. Louis	27,658.1	29,928.3	2,270.2	8.2
Minneapolis	25,205.7	26,361.0	1,155.3	4.6
Kansas City	36,411.0	38,908.4	2,497.4	6.9
Dallas	35,250.6	37,512.3	2,261.7	6.4
San Francisco	60,900.3	66,600.3	5,700.0	9.4
Total, all Districts	**547,713.5**	**584,185.3**	**36,471.8**	**6.7**

1. Excluding salary expenses associated with T-DAB, Philadelphia's increase is 7.4 percent. Philadelphia's salary expenses are materially affected because T-DAB expenses are not shared among Districts.

Table 3.B.7

Factors in 1985–86 Change in Salaries of Officers and Employees of Federal Reserve Banks, by District

Percentage points

District	Merit adjustment	Structure adjustment	Promotions and reclassifications	Change in staffing	Turnover and lag	Overtime	Other
Boston	5.0	0	1.1	.3	−.7	−1.5	.6
New York	5.3	0	.5	−.5	−1.1	0	.3
Philadelphia	3.9	.6	.9	6.4	0	−.2	.1
Cleveland	4.9	.1	.8	2.8	−1.6	−.1	.1
Richmond	4.7	0	1.4	2.0	−1.7	−.7	.1
Atlanta	4.4	.5	.8	3.0	−.4	−1.4	0
Chicago	4.7	0	2.4	1.4	−1.0	−.6	0
St. Louis	3.9	.1	.5	3.7	0	−.1	.2
Minneapolis	4.5	0	.4	−.2	0	−.6	.6
Kansas City	4.3	.4	1.5	2.5	−1.7	−.2	0
Dallas	4.8	.3	.6	6.6	−3.9	−.2	0
San Francisco	5.0	0	.5	5.3	−1.2	−.2	0
Total, all Districts	**4.8**	**.1**	**1.0**	**2.3**	**−1.2**	**−.4**	**.2**

Table 3.B.8

Capital Outlays of the Federal Reserve Banks, by District, 1985 and 1986

Thousands of dollars, except as noted

District	1985 Estimate	1986 Budget	Change, 1985–86	
			Amount	Percent
Boston	8,608.2	8,100.2	−508.0	−5.9
New York	19,204.4	43,062.0	23,857.6	124.2
Philadelphia	8,422.8	7,378.7	−1,044.1	−12.4
Cleveland	15,634.3	10,862.8	−4,771.5	−30.5
Richmond	11,602.9	10,195.6	−1,407.3	−12.1
Atlanta	18,406.1	23,910.1	5,504.0	29.9
Chicago	18,137.9	49,096.2	30,958.3	170.7
St. Louis	5,273.4	6,027.0	753.6	14.3
Minneapolis	5,983.5	4,840.2	−1,143.3	−19.1
Kansas City	20,250.9	10,929.3	−9,321.6	−46.0
Dallas	5,971.3	8,861.2	2,889.9	48.4
San Francisco	34,265.1	48,119.1	13,854.0	40.4
Total, all Districts	**171,760.8**	**231,382.4**	**59,621.6**	**34.7**

Table 3.B.9

Capital Outlays by Federal Reserve Banks, by Class, by District, 1985 and 1986

Thousands of dollars

District and year	Data processing and data communication equipment	Furniture, furnishings, and fixtures	Other equipment	Land and other real estate	Buildings	Building machinery and equipment	Leasehold improvements	Total capital outlays
Boston								
1985 estimate . . .	6,579.8	346.8	592.4	20.0	582.0	137.2	350.0	8,608.2
1986 budget	6,812.7	176.8	380.7	0	640.0	90.0	0	8,100.2
New York								
1985 estimate . . .	10,546.4	1,447.8	2,466.6	0	4,729.3	9.4	4.9	19,204.4
1986 budget	13,200.0	2,030.5	2,474.7	5,000.0	20,153.2	75.6	128.0	43,062.0
Philadelphia								
1985 estimate . . .	6,536.9	196.0	1,105.1	0	0	479.8	105.0	8,422.8
1986 budget	5,993.5	415.7	804.3	0	0	0	165.2	7,378.7
Cleveland								
1985 estimate . . .	9,534.7	452.8	1,251.0	20.0	4,101.9	266.1	7.8	15,634.3
1986 budget	4,912.4	1,135.2	701.4	75.0	2,156.0	1,957.8	0	10,937.8
Richmond								
1985 estimate . . .	8,675.9	811.9	855.5	0	1,033.2	217.4	9.0	11,602.9
1986 budget	6,538.4	294.2	828.6	27.0	2,459.4	0	0	10,147.6
Atlanta								
1985 estimate . . .	8,051.6	871.2	907.0	957.5	6,226.1	1,392.7	0	18,406.1
1986 budget	14,478.6	1,984.0	1,640.6	0	4,860.7	919.2	0	23,833.1
Chicago								
1985 estimate . . .	10,697.6	559.4	964.2	0	5,635.7	136.0	145.0	18,137.9
1986 budget	11,251.9	1,223.2	990.9	0	35,242.2	216.5	171.5	49,096.2
St. Louis								
1985 estimate . . .	2,125.7	413.5	611.8	0	1,545.8	576.6	0	5,273.4
1986 budget	1,894.7	150.4	330.4	0	3,024.5	627.0	0	6,027.0
Minneapolis								
1985 estimate . . .	5,221.0	11.7	653.9	0	65.0	31.9	0	5,983.5
1986 budget	3,558.6	40.5	503.6	4.5	533.0	200.0	0	4,840.2
Kansas City								
1985 estimate . . .	4,856.1	1,791.1	1,595.7	967.0	9,240.2	1,800.8	0	20,250.9
1986 budget	4,551.8	1,060.5	1,325.7	104.0	2,703.9	1,183.4	0	10,929.3
Dallas								
1985 estimate . . .	3,705.8	636.2	465.2	0	858.0	300.7	5.4	5,971.3
1986 budget	4,973.3	717.0	848.7	10.0	1,132.7	1,109.5	70.0	8,861.2
San Francisco								
1985 estimate . . .	5,393.9	661.2	1,587.8	10.0	25,427.7	783.4	401.1	34,265.1
1986 budget	13,709.6	851.5	1,334.6	0	30,854.7	948.7	420.0	48,119.1
Total, all Districts								
1985 estimate . . .	**81,925.4**	**8,199.6**	**13,056.2**	**1,974.5**	**59,444.9**	**6,132.0**	**1,028.2**	**171,760.8**
1986 budget	**91,875.5**	**10,079.5**	**12,164.2**	**5,220.5**	**103,760.7**	**7,327.7**	**954.7**	**231,382.4**

Table 3.B.10

Budget Performance of the Federal Reserve Banks,
Total Expenses, by District, 1985

Thousands of dollars, except as noted

District	1985 Budget	1985 Estimate	Difference	
			Amount	Percent
Boston	65,533.0	66,347.4	814.4	1.2
New York	225,607.5	218,941.1	−6,666.4	−3.0
Philadelphia	61,897.4	61,942.2	44.8	.1
Cleveland	64,653.8	65,351.0	697.2	1.1
Richmond	87,537.3	88,279.9	742.6	.8
Atlanta	99,954.5	100,731.5	777.0	.8
Chicago	133,657.8	133,575.8	− 82.0	− .1
St. Louis	57,342.4	56,505.7	− 836.7	−1.5
Minneapolis	55,359.0	55,659.7	300.7	.5
Kansas City	72,372.6	71,373.7	− 998.9	−1.4
Dallas	70,204.7	72,276.9	2,072.2	3.0
San Francisco	128,215.0	129,419.0	1,204.0	.9
Total, all Districts	**1,122,335.0**	**1,120,403.9**	**−1,931.1**	− .2

Table 3.B.11

Budget Performance of the Federal Reserve Banks,
Average Number of Personnel, by District, 1985

Number, except as noted

District	1985 Budget	1985 Estimate	Difference	
			Amount	Percent
Boston	1,425	1,468	43	3.0
New York	4,205	4,205	0	0
Philadelphia	1,195	1,184	−11	−.9
Cleveland	1,411	1,413	2	.1
Richmond	1,958	1,963	5	.3
Atlanta	2,077	2,151	74	3.6
Chicago	2,820	2,844	24	.9
St. Louis	1,265	1,269	4	.3
Minneapolis	1,092	1,115	23	2.1
Kansas City	1,584	1,597	13	.8
Dallas	1,447	1,496	49	3.4
San Francisco	2,330	2,369	39	1.7
Total, all Districts	**22,809**	**23,074**	**265**	**1.2**

Table 3.B.12

Budget Performance of the Federal Reserve Banks,
Average Number of Personnel, by Service Line, 1985

Number, except as noted

Service line	1985 Budget	1985 Estimate	Difference	
			Number	Percent
Monetary and economic policy	833	813	−20	−2.4
Supervision and regulation	1,903	1,918	15	.8
Services to financial institutions and the public	8,441	8,741	300	3.6
Services to U.S. Treasury and government agencies	1,825	1,784	−41	−2.2
Support	4,390	4,431	41	.9
Overhead	5,417	5,387	−30	− .6
Total, all service lines	**22,809**	**23,074**	**265**	**1.2**

Appendix 3.C

Budget Performance of the Federal Reserve Banks, 1984 and 1985

The Federal Reserve Board follows the concept of "target budgeting" rather than strict budget ceilings. It strongly encourages Reserve Banks to offset unexpected resource requirements with decreases in items of lower priority when at all possible; but it permits increases in the budget. The target budget concept requires careful review by the Board of budget performance. The result is more realistic budgeting and more careful financial planning.

Table 3.C.1 compares the performance of the Banks against the budget for 1984 and 1985.

For 1984 budgets totaling $1,086 million were approved. Actual expenses in 1984 were $1,068 million, a budget underrun of $18 million, or 1.7 percent. The underrun was due primarily to a decrease in shipping as Reserve Banks withdrew from cash shipping services, allowing the private sector to provide those services to depository institutions. The Board of Governors approved Reserve Bank budgets for 1985 totaling $1,122 million. The Banks now estimate 1985 expenses at $1,120 million, a budget underrun of $1.9 million, or 0.2 percent. This underrun has been achieved even though employment exceeded the budget level by 265, or 1.2 percent; the excess occurred primarily in services to financial institutions, in which volume growth was greater than planned.

Table 3.C.1
Budget Performance of the Federal Reserve Banks, 1984 and 1985

Item	1984			1985		
	Budget	Actual	Percent change	Budget	Estimate	Percent change
Total expenses (millions of dollars)	1,086	1,068	−1.7	1,122	1,120	−.2
Employment (number)	23,029	22,669	−1.6	22,809	23,074	1.2

Appendix 3.D
Federal Reserve Priced Services

The Monetary Control Act of 1980 (MCA) requires the Federal Reserve to charge depository institutions explicitly for their use of Federal Reserve services that had previously been provided without explicit charge to member banks. Since the enactment of the MCA, the Federal Reserve has developed an annual pricing process in conjunction with the annual budgeting process of the Reserve Banks. In contrast to the budget process, whose focus is on cost containment, the objective in the pricing process is to establish fees that will recover the full costs of providing services. As the MCA requires, these costs include all direct and indirect costs, the interest on items credited before actual collection (float), and the return on capital that would have been provided and the taxes that would have been paid had the services been furnished by a private business firm. The cost of capital and taxes is referred to as the private sector adjustment factor (PSAF).

The determination of prices has resulted in additional review of Reserve Bank expenses. Details on the services provided are needed to establish appropriate prices. Use of the budgets is an integral part of the pricing exercise because most of the costs of priced services to be recovered consists of direct and indirect costs as determined by the annual budget process. Prices are generally changed only once a year so that depository institutions can plan their own correspondent banking services more easily. This determination of prices for each calendar year is usually made in the fourth quarter of the preceding year.

Prices for Federal Reserve services are subject to a rigorous review process. Not only must they be approved by the Product Director for the respective service, but also they must be approved by the Pricing Policy Committee and ultimately by the Board of Governors.[16] Prices are set with the anticipation of full cost recovery; that is, it is expected that the revenue generated by fees will cover the total costs of providing priced services including the cost of float and the PSAF. If prices for any service are set so that full cost recovery is not anticipated, the Board announces the rationale for establishing prices at that level.[17]

The cost of float incorporated into the pricing process is determined by applying the current federal funds rate to the level of float expected to be generated in the coming year. The PSAF is based on the application of financing rates determined from a model of the nation's 25 largest bank holding companies to assets used in the Federal Reserve's priced-services

16. The Pricing Policy Committee comprises one of the Board's Governors, the Board's Staff Director for Federal Reserve Bank Activities, the presidents of two Reserve Banks, and the first vice presidents of two other Reserve Banks.

17. An example is the incentive pricing program announced for the ACH service, under which prices were established to recover an increasing percentage of full costs each year, with full cost recovery anticipated in 1986. This procedure was followed to encourage use of the ACH service.

operations. These assets are allocated to priced services on a direct-determination basis that uses the Federal Reserve's Planning and Control System (PACS) to ascertain the value of assets used solely in priced-services operations and to apportion the value of jointly used assets between priced and nonpriced services. The percentages used to allocate assets between priced and nonpriced services are based on the anticipated PACS cost distributions, redistributions, and allocations for the coming year that are used in the determination of Reserve Bank budgets. In addition, the assets that the Banks expect to acquire or dispose of in the coming year are factored into the PSAF asset base. Finally, other components of the PSAF are calculated using budget data: the imputed sales tax, based on budgeted outlays for materials, supplies, and capital assets; the assessment for FDIC insurance on expected clearing balances maintained with the Federal Reserve to settle transactions; and the portion of the expenses of the Board of Governors that is related to priced services.

The inclusion of these costs along with actual operating costs in the determination of prices for services, as well as the discipline of the market requiring that these prices be competitive, ensures that costs of priced services will be no higher than necessary.

Calculation of PSAF for 1986

In 1985, the Board approved a 1986 private sector adjustment factor for Federal Reserve priced services of $68.1 million, an increase of $7 million, or 11.3 percent, from the PSAF of $61.1 million targeted for 1985.

Asset Base

The estimated value of Federal Reserve assets to be used in providing priced services in 1986 is reflected in table 3.D.1. As shown in table 3.D.2, which compares the calculations for 1985 and 1986, the value of assets assumed to be financed through debt and equity will total $350.5 million in 1986, which represents an increase of $37.4 million, or 12 percent, from 1985, attributable largely to capital expenditures for bank premises, furniture, and equipment.[18]

Cost of Capital and Taxes

Because of abnormal earnings by bank holding companies included in the model, the Board approved the use of a three-year average of rates of return on equity for calculating the 1985 PSAF. Although earnings of the largest bank holding companies improved in 1985, the rate of return on equity did not regain its former level. For example, the aftertax return on equity for the largest bank holding companies averaged 10.5 percent for the 12 months ended June 30, 1985, compared with an average aftertax rate of return of 12.3 percent for the three-year period 1982–84. Therefore, in 1986 the Board again approved the three-year averaging technique to obtain a more representative cost of equity, and also used three-year averages for determining imputed interest costs for long-term debt and for income taxes.

The sample of 25 bank holding companies used to calculate the rates

18. Short-term assets are assumed to be financed by short-term liabilities; long-term assets are assumed to be financed by a combination of long-term debt and equity.

for 1986 is slightly different from the sample used for 1985. One bank was replaced by another because of unique circumstances it experienced during the previous year. The holding companies with the highest and the lowest rates of return on equity before taxes were excluded, and calculations were based on the remaining 23 companies.

Other Imputed Costs

Other required PSAF recoveries for 1986 for sales taxes, FDIC insurance, and Board expenses total $11 million, up $1 million from 1985 (see table 3.D.2). Most of the increase is in imputed sales taxes, which rose primarily because of the increase in capital

Table 3.D.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 1985 and 1986[1]

Millions of dollars

Asset or liability	1985		1986	
Assets				
Short-term assets				
Imputed reserve requirements on clearing balances	$ 156.0		$ 204.0	
Investment in marketable securities	1,144.0		1,496.0	
Receivables[2]	24.4		25.9	
Materials and supplies[2]	4.4		4.2	
Prepaid expenses[2]	6.9		4.2	
Net items in process of collection (float)	247.5		334.0	
Total short-term assets		$1,583.2		$2,068.3
Long-term assets				
Premises[2,3]	166.0		191.0	
Furniture and equipment[2]	110.2		123.4	
Leases	.7		.2	
Leasehold improvements[2]	1.2		1.8	
Total long-term assets		278.1		316.4
Total assets		**$1,861.3**		**$2,384.7**
Liabilities				
Short-term liabilities				
Clearing balances	$1,300.0		$1,700.0	
Balances arising from early credit of uncollected items	247.5		334.0	
Short-term debt[4]	35.7		34.3	
Total short-term liabilities		$1,583.2		$2,068.3
Long-term liabilities				
Obligations under capital leases	.7		.2	
Long-term debt[4]	92.9		94.9	
Total long-term liabilities		93.6		95.1
Total liabilities		1,676.8		2,163.4
Equity[4]		184.5		221.3
Total liabilities and equity		**$1,861.3**		**$2,384.7**

1. Data are averages for the year. Details may not add to totals because of rounding.

2. Financed through PSAF; other assets are self-financing.

3. Includes allocations of $400,000 in Board of Governors' assets to priced services for 1985 and 1986.

4. Imputed figures; represent the source of financing for certain priced-service assets.

expenditures planned for 1986. The remainder of the increase is in imputed costs for FDIC insurance, resulting from the expected rise in clearing balances reflected in table 3.D.1.

Table 3.D.2

Derivation of the Private Sector Adjustment Factor, 1985 and 1986[1]

Millions of dollars, except as noted

Item	1985	1986
Assets to be financed[2]		
Short-term	35.7	34.3
Long-term[3]	277.4	316.2
Total	**313.1**	**350.5**
Capital structure (percent)		
Short-term	11.4	9.8
Long-term	29.7	27.1
Equity	58.9	63.1
Total	**100.0**	**100.0**
Financing rates[4] (percent)		
Short-term debt	9.93	10.27
Long-term debt	10.38	10.28
Pretax equity[5]	20.55	19.78
Weighted average cost of capital	**16.32**	**16.28**
Tax rate (percent)[5]	36.90	37.64
Elements of capital cost[6]		
Short-term debt	3.5	3.5
Long-term debt	8.6	9.8
Equity	39.9	43.8
Total	**52.0**	**57.1**
Other required recoveries		
Sales taxes	7.2	7.9
Assessment for federal deposit insurance	1.1	1.4
Expenses of Board of Governors	1.7	1.7
Total	**10.0**	**11.0**
Total PSAF recoveries	**61.1**	**68.1**
As a percent of capital	**9.5**	**19.4**
As a percent of expenses[7]	**15.2**	**15.7**

1. Details may not add to totals because of rounding.
2. The asset base for priced services is directly determined.
3. Total long-term assets less capital leases that are self-financing.
4. All short-term assets are assumed to be financed by short-term debt. Of the total long-term assets, 30 percent are assumed to be financed by long-term debt and 70 percent by equity. The data are average rates paid by the bank holding companies included in the sample (see text).
5. The pretax rate of return on equity is based on average aftertax rates of return on equity for the sample of bank holding companies, adjusted by the effective tax rate to yield the pretax rate of return on equity. The 1986 figures for pretax equity and the tax rate are based on a three-year average of these rates, for 1982–84.
6. The calculations underlying these data use the numbers for assets to be financed, divided as described in note 4, and those for the financing rate or cost.
7. In 1985, Systemwide expenses for priced services less shipping were $400.5 million. For 1986, the initial budgeted figure is $434.4 million.

Chapter 4
Expenses and Budget of the Board of Governors

This chapter presents an overview of the budget of the Board of Governors and then examines expenses for the major service lines identified in chapter 2.[1]

Overview of the Budget

The 1986 budget of the Board of Governors was developed with a view toward continuing restraint. The factors holding down expenses include a two-year planned reduction of staff, which began in 1985; the exclusion of a general pay increase; and management initiatives that will reduce insurance and retirement costs. Offsetting these decreases in costs are two factors that will raise expenses: the need for an expansion of resources for the supervision and regulation of financial institutions; and efforts to increase productivity through automation, including a major investment in a new computer mainframe. Overall, the operating budget embodies an increase of 5.4 percent over estimated expenses for 1985. Tables 4.1 and 4.2 compare the actual expenses for 1984, estimated expenses for 1985, and budgeted expenses for 1986, and chart 4.1 depicts the relation of Board expenses to expenses for the System as a whole in 1986.

Personnel Services

In August 1984, the Board initiated a review of all Board functions with the aim of eliminating lower-priority work while enhancing productivity. This review, planned as an extension of the regular budget process and called the Program Improvement Project (PIP), had the specific objective of reducing Board positions by 7 percent. To minimize staff disruption and the cost of the review, implementation was scheduled to occur over the two years 1985 and 1986. Resources have been redirected to emerging high-priority functions, especially in the area of supervision and regulation. Employment in other areas, notably the research and support functions, continues to fall.

While the initial authorization for 1986 shows a net increase of 24 positions over the 1985 year-end authorization of 1,616, the total will drop to 1,584 positions by year-end. The initial increase is required in bank supervision and regulation, but will be offset during the year with further re-

1. The Board's budget process is discussed in appendix 4.A.

Chart 4.1
Budget for the Federal Reserve Board, 1986

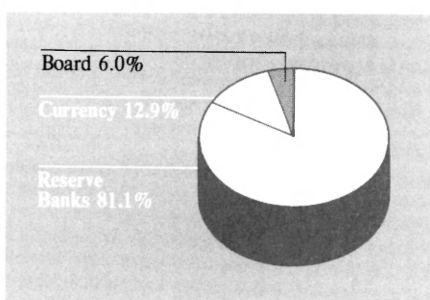


Table 4.1
Operating and Capital Budgets of the Board of Governors, 1984-86
Thousands of dollars, except as noted

Type of budget and service	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985-86
Operating budget				
Personnel services	56,992	59,710	61,008	2.2
Nonpersonnel services	19,790	22,466	25,583[1]	13.9
Total operating expenses	**76,782**	**82,176**	**86,591**	**5.4**
Capital budget				
General	....	4,147	4,160	.3
Computer upgrade	....	....	14,000	....

1. Includes $1.8 million in depreciation expense for a new computer, whose acquisition cost is included in the capital budget.

ductions from PIP. These reductions will hold down expenses for salaries and fringe benefits. The total savings of $4.5 million (annual rate) from reductions in staff will not accrue fully, however, until 1987.

The 1986 budget for personnel services is 2.2 percent greater than comparable expenses in 1985. This increase is significantly smaller than those registered in recent years. Savings from reductions in staff, reductions in retirement and health insurance costs, and the exclusion of a pay increase are offset by increases resulting from the full-year effect of salary actions taken in 1985, such as progress step increases and reclassifications, and one-time costs associated with the reductions in staff from PIP.

Nonpersonnel Services

The operating budget for nonpersonnel services in 1986 is expected to total $25.6 million—$3.1 million, or 13.9 percent, more than in 1985. One of the largest factors in this rise is an increase of $1.8 million in depreciation (see below). The remainder of the increase, $1.3 million, results from increases in funding for computer software for the mainframe and contingency operating systems ($917,000); an expansion in travel owing to the step-up in supervision of financial institutions and to the greater number of operations reviews of Reserve Banks ($330,000); a rise in maintenance costs for a greater volume of data processing equipment ($338,000); an increase in leased software and peripheral equipment ($286,000); and an increase in the accounts for postage and for heat, light, and power caused by greater use and higher rates ($277,000). An offset to these increases in expenses is an expected increase of $866,000 in income from the Reserve Banks for their share of expenses associated with the Contingency Processing Center, described later in this chapter.

Capital Budget and Depreciation

The capital budget for 1986 totals $18,160,000. Of this amount, $14 million is to replace the Board's mainframe computer. The remaining $4,160,000 will support expansion of automation—for instance, with microcomputers—intended to raise

Table 4.2
Expenses of the Board of Governors by Object Class, 1984–86
Thousands of dollars, except as noted

Type of service and object class	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Personnel services[1]				
Salaries	51,022	53,521	55,173	3.1
Retirement	3,128	3,153	2,944	− 6.6
Insurance	2,842	3,036	2,891	− 4.8
Total	56,992	59,710	61,008	2.2
Nonpersonnel services				
Travel	2,072	2,370	2,700	13.9
Contractual and professional services	2,191	2,846	3,995	40.4
Printing and binding	1,178	1,091	1,052	− 3.6
Heat, light, and power	1,311	1,493	1,625	8.8
Rentals	1,814	3,070	3,230	5.2
Telephone and telegraph	1,496	1,327	1,353	2.0
Repairs, maintenance, and alterations	1,519	1,973	2,311	17.1
Postage and supplies	1,801	2,569	2,702	5.2
Fees, books, and tuition	940	1,037	1,339	29.1
Depreciation	3,578	4,974	6,734	35.4
CPC income[2]	....	−982	−1,848	88.2
Other	1,890	698	390	−44.1
Total	19,790	22,466	25,583	13.9
Total operating expenses	**76,782**	**82,176**	**86,591**	**5.4**

1. The Board Retirement Plan is a contributory plan that is substantially identical to the Civil Service Retirement System (CSRS), utilizing a formula based on the final average salary of the three highest consecutive years and length of service. Like those of the CSRS, benefits are not integrated with social security. Eligibility for regular retirement is based on a combination of age and service, vesting is at five years of service, and death benefits are provided. Medical and dental insurance plans are negotiated separately by the Board's Division of Personnel. Both plans require the employee to share in the costs, and in the last few years both have been subject to significant cost containment measures and to reductions in premiums. The thrift plan is a voluntary savings and investment program in which an employee may participate after six months' service. The Board contributes a percentage of the employee's contribution up to the first 6 percent of salary. Vesting of employer contributions is based on years of participation, with full vesting at five years.

2. The Contingency Processing Center (CPC) was established and began operational testing in 1984. It was not placed in operation until April 1985 (see text). The income is shown here as a negative expense.

productivity. The 1986 operating budget includes an increase in depreciation expense of $1.8 million (35.4 percent) over 1985, resulting primarily from depreciation on the new mainframe computer and on major office automation acquisitions. Depreciation for the Contingency Processing Center, which was in operation for only nine months in 1985, will be charged for the full year in 1986.

Contingency Processing Center

An important factor in the recent increase in Board operating expenses was the establishment of the Contingency Processing Center (CPC). This facility backs up the critical data processing applications of the Board of Governors and the Federal Reserve Banks. The CPC was established in 1984 and began operations in 1985. The Board's share of its operating cost for 1984 was $667,000. Expenses are estimated at $2.1 million in 1985 and budgeted at $2.6 million for 1986. In both years there are substantial increases for depreciation of the capital costs incurred to establish the facility.

Table 4.3
Operating Expenses of the Board of Governors, by Service Line, 1984–86[1]
Thousands of dollars, except as noted

Service line	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Monetary and economic policy	42,087	45,456	46,938	3.3
Supervision and regulation	18,110	18,773	20,629	9.9
Services to financial institutions and the public	2,499	2,554	2,781	8.9
System policy direction and oversight	14,086	15,393	16,243	5.5
Total, all service lines	**76,782**	**82,176**	**86,591**	**5.4**

1. These figures do not include capital outlays, discussed in the text. The table also omits the service line, services to U.S. Treasury and government agencies, listed in table 2.4, because that function is performed by the Federal Reserve Banks only.

The Board's Expenses by Service Line

As table 4.3 shows, the 1986 budget calls for increases of 3.3 percent in expenses for monetary and economic policy, 9.9 percent for supervision and regulation, 8.9 percent for services to financial institutions and the public, and 5.5 percent for System policy direction and oversight. A large portion of each increase reflects expenses for new office automation equipment to carry out the 1985 Board policy that emphasizes end-user computing as a means to improve productivity. A major initiative in supervision and regulation is the broadening of the examination function.

The Board does not provide direct services to the U.S. Treasury and other government agencies as performed and defined by the Federal Reserve Banks, so this service line is omitted from the tables and discussion in this chapter. Funding for Board oversight of Reserve Bank activities in this area is included in a separate line, System policy direction and oversight, which is unique to the Board. This line also includes funding for the activities of Board Members and all other resources used in the oversight, direction, and supervision of System and Board objectives.

Monetary and Economic Policy

Under its monetary and economic policy function the Board monitors and analyzes developments in the money and credit markets, sets reserve requirements, approves changes in the discount rate, and otherwise manages the nation's monetary policy. The cost of this function at the Board is budgeted to increase $1,482,000, or 3.3 percent, over 1985 estimates (see table 4.4). The relatively small increase masks a large difference in the rates of growth of the two categories within the function.

Development and dissemination of economic intelligence includes domestic and international economic research, which in turn includes current and long-range studies.[2] Small in-

2. The studies are in the following areas, covered by sections in the Board's Division of Research and Statistics and Division of International Finance: banking, financial reports, financial studies, industrial output, capital markets, economic activity, mortgage and consumer finance, flow of funds, government finance, special studies, econometric and computer applications, international banking, in-

Table 4.4
Expenses by the Board of Governors for Monetary and Economic Policy, 1984–86[1]
Thousands of dollars, except as noted

Category	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Monetary and economic policy, total	42,087	45,456	46,938	3.3
Development and dissemination of economic intelligence[2]	34,079	35,623	35,843	.6
Program direction	8,008	9,833	11,095	12.8

1. These figures do not include capital outlays, discussed in the text.

2. See text note 3 for a full description of this function.

creases in funding were approved for current surveys. New studies to be conducted during 1986 include a survey of small businesses to provide data on how they use financial institutions and a reinterview of the 1983 Survey of Consumer Finances panel. No expansion is proposed in the expenses for providing the economic and financial information and analysis needed by the Board, the Federal Open Market Committee, and System officials to carry out their monetary policy and regulatory responsibilities.

Under the subfunction of program direction, budgeted expenses for 1986 exceed the estimate for 1985 by $1,262,000, or 12.8 percent. A significant portion of this increment is the result of planned initiatives in office automation and management information systems that will contribute to more effective information gathering, analysis, preparation, and presentation. When fully operational, work-area networks have the potential to relieve the Board's mainframe computer of 20 percent of the demands on it for the monetary and economic policy function. The planning and installation of the work-area network will peak in 1986 and should be completed by 1988, at a total cost of approximately $2 million.

ternational financial markets, world payments and economic activity, U.S. international transactions, international development, international trade and financial studies, and international quantitative studies.

Supervision and Regulation

Supervision and regulation of financial institutions at the Board consist of three main activities. *Supervision* includes reviews of examination and inspection reports from the Reserve Banks, special studies related to international applications, direction of enforcement actions, and regulation of trust activities. *Regulation* includes writing regulations, as well as reviews of various aspects of Board responsibility for mergers, foreign banking activities, compliance with consumer regulations, regulation of securities credit, and simplification of regulations. *Program direction* includes oversight, management, and administrative support for this service line.

Expenses for supervision and regulation are expected to be $20,629,000 in 1986—$1.9 million, or 9.9 percent, more than in 1985 (see table 4.5). Al-

Table 4.5

Expenses by the Board of Governors for Supervision and Regulation, 1984–86[1]

Thousands of dollars, except as noted

Category	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Supervision and regulation, total	18,110	18,773	20,629	9.9
Supervision	12,732	13,181	14,650	11.1
Regulation	2,739	2,552	2,831	10.9
Program direction	2,639	3,040	3,148	3.6

1. These figures do not include capital outlays, discussed in the text.

Table 4.6

Expenses by the Board of Governors for Services to Financial Institutions and the Public, 1984–86[1]

Thousands of dollars, except as noted

Category	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Services to financial institutions and the public	2,499	2,554	2,781	8.9

1. These figures do not include capital outlays, discussed in the text.

though activity under all three subcategories is expected to expand in 1986, expenses for supervision and for regulation are experiencing significant increases, 11.1 percent ($1,469,000) and 10.9 percent ($279,000) respectively. A major upgrade and expansion of the Board's examination, enforcement, supervision, and applications processing functions are planned for 1986.[3] Generally, the plan calls for increases in the frequency of examinations of state member banks and bank holding companies and the strengthening of procedures for reporting deficiencies to the banks' managements and boards of directors.

3. Details of the Board's plans were announced in a press release on October 7, 1985.

Services to Financial Institutions and the Public

Services to financial institutions and the public cover support and oversight of the payments mechanism functions of the Federal Reserve Banks and Branches. Specifically, this service line includes evaluation of the operational and pricing performance for the check payment activities of the Federal Reserve Banks; oversight of the electronic payments mechanism; and annual evaluation of the Federal Reserve System's currency, coin, and food coupon operations. The Board's staff provides oversight and control in these areas; however, the Reserve Banks provide direct management of these operations.

The increase of 8.9 percent projected in the 1986 budget stems from increases in data processing costs, the most significant of which are related

Table 4.7
Expenses by the Board of Governors for System Policy Direction and Oversight, 1984–86[1]

Thousands of dollars, except as noted

Category	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
System policy direction and oversight, total	14,086	15,393	16,243	5.5
System policy direction	5,045	4,852	5,114	5.4
Oversight	9,041	10,541	11,129	5.6

1. These figures do not include capital outlays, which are discussed in the text.

to float and daylight overdrafts. For the latter, the increase involves intensified monitoring of commercial banks that use Fedwire. It follows extensive study by the Board of actions to reduce daylight overdrafts and to lessen the risks associated with large-dollar transfers on Fedwire and private wire systems.

System Policy Direction and Oversight

System policy direction and oversight includes resources for oversight, direction, and supervision of System and Board programs. Included in this service line are oversight of Federal Reserve Bank programs directly supporting Board Members in carrying out their functions and operations, budgeting and accounting, financial examinations, audit and operations reviews, and automation and communication.

For 1986, a net increase of $850,000, or 5.5 percent, over 1985 estimated expenses is tied to increases in the scope and cost of financial examinations of the Federal Reserve Banks and to bank automation and audit efforts (see table 4.7). The scope and responsibility of the Bank financial examination program have broadened over the last several years to encompass the review of local priced services, large-dollar transfers, discretionary expenditures, and conformance to various System guidelines. In 1986, audits of electronic data processing (EDP) at the Banks will be broadened to allow for a more critical assessment of the adequacy and reliability of data processing controls and to strengthen internal EDP audit capability. The 1986 budget also provides additional and upgraded microcomputers in accordance with a 1985 office automation plan for enhancing the oversight function.

Trends in Board Expenses, 1977–86

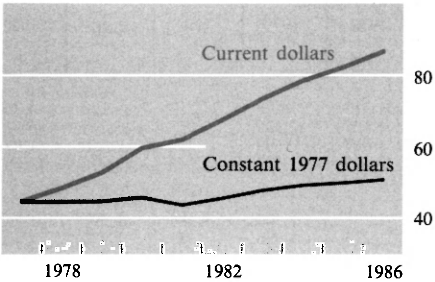
Data on the expenses of the Board of Governors for the years 1977–86 are shown in chart 4.2 and table 4.8. Expenses in constant, 1977 dollars were flat through 1981, and they rose 3.4 percent per year from 1981 through 1985. The real increase budgeted for 1986 is 1.8 percent.

The decrease in the rate of growth in expenses is very noticeable for salaries and other costs for personnel, which account for over 70 percent of the Board's expenses. The average annual rate of increase for salary ex-

Chart 4.2

Expenses of the Board of Governors, Current and Constant Dollars, 1977–86

Millions of dollars



Constant dollars are 1977 dollars, deflated with the GNP implicit price deflator.

Table 4.8

Expenses of the Board of Governors, Current and Constant Dollars, 1977–86

Millions of dollars, except as noted

Year or rate of change	Current dollars	Constant 1977 dollars[1]
Year		
1977	44.8	44.8
1978	48.5	44.8
1979	52.8	45.0
1980	59.1	45.7
1981	61.8	44.0
1982	67.4	45.9
1983	71.9	47.2
1984	76.8	48.6
1985 (estimate)	82.2	50.3
1986 (budget)	86.6	51.2
Rate of change		
1977–85, compound	7.9	1.5
1985–86	5.4	1.8

1. Deflated with the GNP implicit price deflator.

pense was 9 percent from 1977 through 1981, but it falls to 6.1 percent for the years 1981–86 (see table 4.9). The 3.1 percent increase for 1986 is the lowest for any year during the entire period.

The relatively high rates of increase in salaries for 1977–81 were caused by large general pay increases and a slightly higher level of employment. From 1981 to 1984, the general pay increases were lower than in earlier years; however, the Monetary Control Act of 1980 and other legislation increased workload, employment, and salary expense. The growth in the data processing staff was particularly large as the Board expanded its data series. The high rate of increase in retirement expenses from 1977 through 1980 was associated with cost-of-living adjustments for retirees; these adjustments are tied to the consumer price index, which rose rapidly during that period. Expense for employee insurance jumped in 1983, when the Board began its required contributions to the Medicare fund; moreover, other health insurance costs rose sharply from 1977 through 1984.

The decline in employment anticipated for 1986 is associated with an expansion of automation initiatives taken in recent years. Productivity increases that accompany intensive automation allow the Board to reduce its staff to the levels that prevailed in 1978–80, before the new legislation. The automation initiatives have had a noticeable impact on Board expenses. Expenses for microcomputers, software, and peripheral data processing equipment are up substantially in 1984–86. Depreciation expense associated with purchases of automation equipment, including a new mainframe in 1986, is also up. Personnel expenses, which accounted for 77 percent of the Board's expenses in 1977, will fall to 70 percent of the total in 1986. Table 4.10 and chart 4.3 portray these data.

Recognizing the critical role of computing at the Board and Reserve Banks, and to comply with an Executive Order, the Board established the Contingency Processing Center in 1984. This facility added $0.7 million, $2.1 million, and $2.6 million respectively to the Board's expenses for

Table 4.9

Expenses of the Board of Governors, by Object Class, 1977-86

Thousands of dollars, except as noted

Type of service and object class	1977	1978	1979	1980	1981	1982
Personnel services						
Salaries	29,022	31,213	33,572	37,512	41,230	44,254
Retirement	4,744	5,627	7,349	9,057	5,278	6,321
Insurance	640	687	690	779	950	1,278
Total	34,406	37,527	41,611	47,348	47,458	51,853
Nonpersonnel services						
Travel	1,041	1,175	1,300	1,586	1,591	1,765
Contractual and professional services	973	776	936	1,185	1,270	1,428
Printing and binding	477	487	697	1,652	1,792	1,289
Heat, light, and power	837	877	925	967	1,274	1,269
Rentals	1,670	1,688	1,200	791	868	1,229
Telephone and telegraph	790	683	658	686	863	1,039
Repairs, maintenance, and alterations	348	402	508	489	788	983
Postage and supplies	753	822	1,108	1,152	1,215	1,501
Fees, books, and tuition	526	576	527	629	740	856
Depreciation	1,583	1,656	1,859	2,023	3,119	3,155
CPC income	0	0	0	0	0	0
All other	1,401	1,880	1,512	605	824	1,064
Total	10,399	11,022	11,230	11,765	14,344	15,578
Total operating expenses	**44,805**	**48,549**	**52,841**	**59,113**	**61,802**	**67,431**

Type of service and object class	1983	1984	1985 (estimate)	1986 (budget)	Percent change	
					1977-85, compound	1985-86
Personnel services						
Salaries	47,154	51,022	53,521	55,173	8.0	3.1
Retirement	5,423	3,128	3,153	2,944	-5.0	- 6.6
Insurance	2,226	2,842	3,036	2,891	21.5	- 4.8
Total	54,803	56,992	59,710	61,008	7.1	2.2
Nonpersonnel services						
Travel	1,901	2,072	2,370	2,700	10.8	13.9
Contractual and professional services	1.984	2,191	2,846	3,995	14.4	40.4
Printing and binding	820	1,178	1,091	1,052	10.9	-3.6
Heat, light, and power	1,290	1,311	1,493	1,625	7.5	8.8
Rentals	1,411	1,814	3,070	3,230	7.9	5.2
Telephone and telegraph	1,266	1,496	1,327	1,353	6.7	2.0
Repairs, maintenance, and alterations	1,169	1,519	1,973	2,311	24.2	17.1
Postage and supplies	1,458	1,801	2,569	2,702	16.6	5.2
Fees, books, and tuition	832	940	1,037	1,339	8.9	29.1
Depreciation	3,374	3,578	4,974	6,734	15.4	35.4
CPC income [1]	0	0	-982	-1,848	....	88.2
All other	1,602	1,890	698	390	-8.3	-44.1
Total	17,107	19,790	22,466	25,583	10.1	13.9
Total operating expenses	**71,910**	**76,782**	**82,176**	**86,591**	**7.9**	**5.4**

1. The Contingency Processing Center (CPC) was established and began operational testing in 1984. It was not placed in operation until April 1985 (see text). The income is shown here as a negative expense.

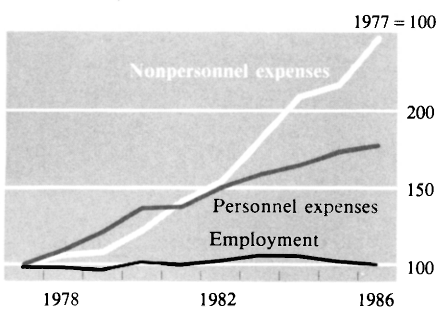
1984, 1985, and 1986. The increases in 1985 and 1986 were primarily for depreciation of the initial acquisition of equipment for the site.

Expenses for repair, maintenance, and alteration of the Board's facilities and equipment have grown rapidly since 1977. The reason lies in sharply higher costs of maintaining data processing equipment (including the

Table 4.10
Trends in Expenses and Employment of the Board of Governors, 1977-86

Year or rate of change	Personnel services		Nonpersonnel services		Year-end employment	
	Dollar amount (millions)	Index	Dollar amount (millions)	Index	Number	Index
1977	34.4	100.0	10.4	100.0	1,478	100.0
1978	37.5	109.1	11.0	106.0	1,473	99.7
1979	41.6	120.9	11.2	108.0	1,451	98.2
1980	47.3	137.5	11.8	113.5	1,525	103.2
1981	47.5	138.1	14.3	137.5	1,501	101.6
1982	51.9	150.9	15.6	150.0	1,537	104.0
1983	54.8	159.3	17.1	164.4	1,591	107.6
1984	57.0	165.7	19.8	190.4	1,588	107.4
1985 (estimate)	59.7	173.4	22.5	216.0	1,535	103.9
1986 (budget)	61.0	177.5	25.6	246.0	1,505	101.8
Rate of change						
1977-85	....	7.1	....	10.1	....	.5
1985-86	....	2.2	....	13.9	....	-2.0

Chart 4.3
Rates of Growth in Expenses and Employment of the Board of Governors, 1977-86



Contingency Processing Center), the aging of the Board's facilities, and investments in energy conservation.

The rates of increase in expenses have differed among the Board's functions, as table 4.11 and chart 4.4 reveal. From 1977 through 1985, the rate of increase for monetary and economic policy, the Board's largest functional area, averaged 8 percent per year. The increase resulted from the Board's response to the provisions of new legislation, particularly the Monetary Control Act, which called for unusual levels of spending for data processing support.

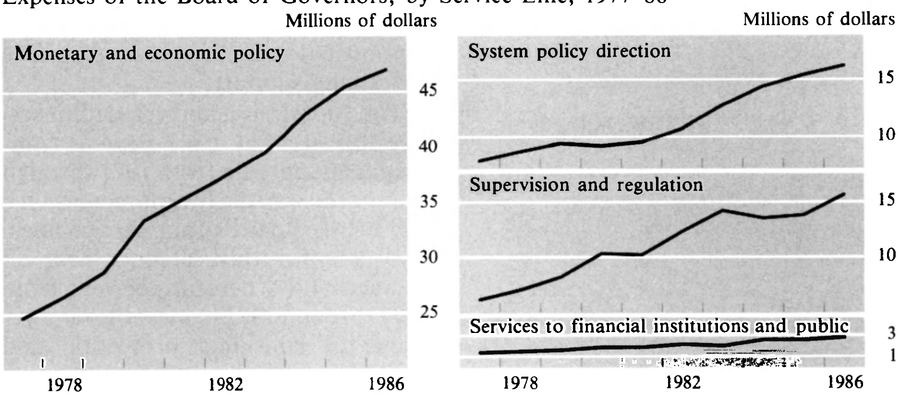
The supervision and regulation service line grew at a 6.7 percent compound annual rate from 1977 through 1985. This was the lowest increase for any of the Board's four service lines. Expenses for this category rose an average of 7.9 percent per year from 1977 through 1981 to meet the requirements of consumer protection and supervisory legislation. Expenses rose sharply in 1982, reflecting data processing costs for the development of the Bank Holding Company Performance Report, which was completed in 1983. With the completion of that report, expenses grew more slowly in 1984. The relatively large increase for 1986 reflects an increase in resources for supervision, for enforcement, and for examiner training.

Expenses for services to financial institutions have risen approximately 8 percent per year since 1977. The 1986 increase of 8.9 percent is consistent with this pattern.

Table 4.11
Expenses of the Board of Governors, by Service Line, 1977–86
Millions of dollars, except as noted

Year or rate of change	Monetary and economic policy	Supervision and regulation	Services to financial institutions	System policy direction
1977	24.6	11.2	1.4	7.7
1978	26.5	12.1	1.5	8.5
1979	28.7	13.2	1.6	9.3
1980	33.1	15.2	1.8	9.0
1981	35.4	15.2	1.9	9.4
1982	37.4	17.3	2.1	10.6
1983	38.7	18.8	2.0	12.4
1984	42.1	18.1	2.5	14.1
1985 (estimate)	45.5	18.8	2.6	15.4
1986 (budget)	46.9	20.6	2.8	16.2
Rate of change				
1977–85 (compound)	8.0	6.7	8.2	9.1
1985–86	3.3	9.9	8.9	5.5

Chart 4.4
Expenses of the Board of Governors, by Service Line, 1977–86



Expenses for System policy direction have felt a heavy impact in recent years from costs of data processing support and from costs associated with improvements in 1985 and 1986 in the Planning and Control System used at the Board and the Reserve Banks.

Appendix 4.A

Budget Formulation for the Board of Governors

The Board uses an annual planning, budget, and control process, based on the calendar year, that involves all divisions at the Board and all levels of management. The Chairman has delegated to the Administrative Governor the responsibility for overseeing Board administrative and management matters. The Administrative Governor plays a key role in ensuring that all elements of the process are coordinated, that all objectives are achieved, that resources are adequate, and that duplication of effort is avoided.

The Board places expenses and employment in four major lines, as described in the text of this chapter: economic and monetary policy, supervision and regulation, services to financial institutions and the public, and System policy direction and oversight. Data processing costs are distributed to the four major areas according to actual usage. Expenses for support and overhead functions are prorated among the four service lines in proportion to their direct costs.

The Budget Schedule

In the spring, each division at the Board is requested to review current and future resource needs. In conjunction with this review the divisions draw on various sources for planning information relevant to their functions, including direct guidance from functional oversight committees made up of Board Members, participation in System strategic planning sessions, and planning sessions within the division itself. Division management prepares a statement of events that can be expected to affect the division's budget and provides initial estimates of budget changes associated with those events. Simultaneously, the Office of the Controller prepares a "current level of operation" budget estimate taking into account known or anticipated factors such as any planned general pay increases for the federal government, changes in costs for retirement and for hospital and medical insurance, and inflation. This projection of expenses is compared with the estimates of expenses in the current year and, along with the input from other divisions, forms the basis for recommending a budget guideline. The Chairman approves the final budget guideline in June, and it is announced to the divisions for use in developing their budgets.

During the summer the divisions prepare their program objectives and budgets. These are reviewed first by administrative management, then by the functional oversight committees. These reviews often result in further adjustments to division budgets. The Administrative Governor then reviews the consolidated budget and discusses it with the Chairman. In early December, the budget is presented to the Board of Governors for action at an open meeting. Division objectives are published for management follow-up, and performance is monitored throughout the year for adherence to the budget objectives and financial allocations.

Capital Budget

Until 1985, the Board of Governors expensed purchases of all assets in the year of purchase. In 1985, the Board began capitalizing certain assets and depreciating their value over appropriate time periods in accordance with generally accepted accounting principles. This approach more closely aligns costs of capital assets with their periods of service and is consistent with the accounting practices that the Federal Reserve Banks follow.

Centrally Provided Services

Because of the heavy cost of mainframe computers and associated support systems, special processes have been established to plan, review, and control expenses for such equipment. Each division or office at the Board must provide, as part of its budget submission, its expected use of data processing resources. These requests for resources are reviewed and subjected to the same cost-benefit analyses as are other resources, in a process that ensures the budgeting of sufficient centrally provided services and efficient use of resources.

Financial Monitoring and Control

Board expenses are monitored and reviewed throughout the budget year by all levels of Board management. To facilitate this monitoring, each division prepares an operating plan at the beginning of the year, which allocates its approved budget into quarterly plans. Actual performance against budgeted targets is monitored monthly by administrative management, and quarterly reports are submitted to the Board.

Each July, division budgets as of June 30 are formally reviewed with division directors in meetings with the Controller and the Staff Director for Management. Results are reported to the Board along with recommendations for reallocations as appropriate. In addition, each year a comprehensive report discussing the previous year's performance in terms of trends in employment and expenses and attainment of objectives is submitted to the Board.

Assessments

The Board of Governors is empowered by the Federal Reserve Act to assess the Federal Reserve Banks for the funds necessary to pay its expenses. After the annual budget is approved, an estimate of the cash requirement for the first half of the year is prepared. The Administrative Governor reviews this estimate and, upon his approval, the required amount is raised by a levy on each of the Reserve Banks in proportion to its capital stock and surplus. In June of each year, the cash requirements to year-end are estimated, and in July the second assessment is made on the Reserve Banks. Although assessments are made semiannually, funds are transferred quarterly in order to minimize cash balances.

Chapter 5
Employment in the Federal Reserve System

Over 60 percent of all the resources of the Federal Reserve System are committed to the salaries and benefits of its employees. This chapter discusses employment in the System in the aggregate, and then discusses it separately for the Federal Reserve Banks and for the Board of Governors and by service line. The chapter also traces the trends in Board and Bank employment, overall and by service line, over the past 10 years.

Total System Employment

System employment is budgeted at 25,047 for 1986, an increase of 438, or 1.8 percent, over 1985 estimated employment of 24,609. Table 5.1 shows employment for the System as a whole and for the Reserve Banks and the Board of Governors separately for 1984, 1985, and 1986.

Board Employment

Employment at the Board of Governors decreased 53 in 1985 and is expected to decline another 30 in 1986. This budgeted decline is part of the Boardwide Program Improvement Project; it is partially offset in 1986 by the additions to the staff for supervision and regulation.[1]

The Board of Governors plans additions to the supervisory and enforcement staff responsible for oversight and increases in Systemwide training efforts in light of the large number of field examiners to be hired between 1985 and 1987.

As table 5.2 shows, only in this service line does the Board expect an increase in employment in 1986: 30 positions will be added at the beginning of the year to support the broader scope and greater frequency of bank and bank holding company examinations. This increase will be partially offset by reductions by year-end in areas of lower priority.

Reserve Bank Employment

Employment at the Reserve Banks increased 405 average number of personnel in 1985 and is expected to increase 468 in 1986.[2] These increases represent growth in the volume of priced services as well as new initiatives, the most significant of which is the intensified program of bank supervision.[3]

The strengthening of supervision and regulation of financial institutions is the most significant influence on employment throughout the Federal Reserve System for 1986. Ex-

1. See chapter 4 for a discussion of the Program Improvement Project and chapters 3 and 4 for fuller discussion of Bank and Board initiatives.

2. The term "average number of personnel," or ANP, is used to describe levels and changes in employment at the Reserve Banks. ANP measures the number of employees in terms of full-time positions for the time period. For instance, a full-time employee who starts work July 1 counts as 0.5 ANP for that year; two half-time employees who start January 1 count as one ANP. The ANP for any given year is the average of the number of full-time employees (measured in this way) in the months of that year.

3. The costs of the staff for priced services are fully recovered through the pricing mechanism. See appendix 3.D.

Table 5.1
Total Employment in the Federal Reserve System, 1984–86

Number, except as noted

Entity	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Reserve Banks[1]	22,669	23,074	23,542	2.0
Board of Governors[2]	1,588	1,535	1,505	−2.0
Total System employment	**24,257**	**24,609**	**25,047**	**1.8**

1. Based on average number of personnel; see text note 1 for explanation.
2. Based on employees at year-end.

Table 5.2
Employment at the Board of Governors, by Service Line, 1984–86[1]

Number, except as noted

Service line	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Monetary and economic policy	507	484	462	−4.5
Supervision and regulation	270	259	275	6.2
Services to financial institutions and the public	24	22	22	0
System policy direction	190	205	194	−5.4
Support services[2]	438	395	391	−1.0
Overhead services[3]	159	170	161	−5.3
Total, all service lines	**1,588**	**1,535**	**1,505**	**−2.0**

1. Based on employment at year-end.
2. Data processing personnel directly employed to support a service line are included with that line. All other data processing personnel are shown in support services. Staff of the Division of Support Services are included in this category.
3. Includes personnel, accounting, and other overhead services.

aminations of commercial banks and inspections of bank holding companies will increase in frequency and scope, and procedures for reporting deficiencies to bank managements and boards of directors will be improved.

The Reserve Banks plan to expand both the number of examiners and inspectors in the field and the number of people on in-house surveillance staffs. Of the total increase of 468 ANP at the Reserve Banks in 1986, 219 are in supervision and regulation.

Other major influences on employment at the Reserve Banks include the Treasury Direct-Access Book-Entry System (T-DAB), notification of the return of large-dollar checks, large increases in the volume of currency and checks handled that cannot be absorbed within current staffing levels, and the continued implementation of jointly developed software.[4]

As table 5.3 shows, these special factors by themselves would cause an increase of 572 ANP in 1986. The budgeted increase of 468, or 104 fewer than required by the special factors alone, reflects the ability of the Reserve Banks to reallocate staff from lower-priority work. For example, in

4. See chapter 3, note 7.

Table 5.3
Impact of Special Factors on Employment at the Federal Reserve Banks, 1986

Special factor affecting employment	Increase in ANP, 1985–86
Enhanced examination program, volume growth, changes in reporting, and increased surveillance	219
Operation of T-DAB	111
Notification of return of large-dollar checks	118
Increases in volume of currency and checks	87
Introduction of jointly developed software[1]	21
Small and disadvantaged business procedures[2]	16
Total, all special factors	**572**

1. See chapter 3, note 7.
2. These are the procedures instituted by the System in response to a legislative requirement to assure that small and minority-owned businesses are not subject to disadvantage in seeking contracts with the Board and the Banks.

1986, for the sixth consecutive year, Reserve Banks plan to reduce staff in overhead; and reductions are also budgeted for noncash collection and for other Treasury issues, and for building and housekeeping services.

Developments at the Reserve Banks

Differences in budgeted changes in employment among the Reserve Banks (as shown in table 5.4) reflect conditions in the various Districts, such as the financial structure and condition of institutions and the volume of business processed, as well as differing schedules for implementing Systemwide programs.

Three Reserve Districts—Boston, New York, and Minneapolis—plan reductions to staff in 1986 because the new supervision policies do not have a heavy impact on them and because for the most part the growth in their volume of priced services is normal. The *Boston* District is reducing staff in currency, check, and data processing as these operations have become more efficient, as volumes have stabilized, and as the demands of transition to System automation standards have eased. Automation has permitted the *New York* District to reduce staff in 1985 and in 1986 in government securities, currency, pur-

Table 5.4
Employment by Federal Reserve District, 1984–86[1]

Average number of personnel, except as noted

District	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985–86
Boston	1,349	1,468	1,461	−.5
New York	4,269	4,205	4,167	−.9
Philadelphia[1]	1,125	1,184	1,259	6.3
Cleveland	1,396	1,413	1,421	.6
Richmond	1,904	1,963	1,981	.9
Atlanta[2]	2,028	2,151	2,215	3.0
Chicago	2,840	2,844	2,888	1.5
St. Louis[3]	1,259	1,269	1,324	4.3
Minneapolis	1,140	1,115	1,108	−.6
Kansas City[3]	1,598	1,597	1,630	2.1
Dallas[3]	1,433	1,496	1,589	6.2
San Francisco[3]	2,284	2,369	2,499	5.5
Total, all Districts	**22,669**	**23,074**	**23,542**	**2.0**

1. Increase in 1986 due primarily to T-DAB.
2. Increases in 1985 and 1986 due primarily to heavier volume in priced services.
3. Increase in 1986 due primarily to intensified supervision and regulation and to heavier volume of priced services.

chasing, accounting, pricing administration, and protection. In the *Minneapolis* District productivity gains are expected to reduce staff in check operations.

For most of the Districts, increasing workloads imposed by System initiatives have called for additions to the staff in 1985 and 1986.

The *Philadelphia* District is adding 75 ANP, 55 of whom are for the T-DAB project. Other increases are necessary in the currency area for implementation of the open-access cash policy, and in the check area for the new program for notification of the return of large-dollar checks.[5]

In the *Cleveland* District the staff involved in supervision and priced services will grow. But this growth will be offset by declines in overhead—primarily through an automated security system that will allow the District to reduce the number of guards at the Columbus regional check-processing center.

The *Richmond* District plans only a small increase in staff in 1986, after a larger one in 1985. The growth in the volume of priced services and in data processing to introduce jointly developed software has required these increases. In 1986, the growth in staff can be attributed almost entirely to the new examination program.

The *Atlanta* District will make large additions to staff in 1986, as it did in 1985. These additions have come in currency and check services and have been due to growth in volume; in the supervision service, in response to the new program; and in the data processing area, to handle the transition to the System's standard environment.[6]

The *Chicago* District plans staff additions in 1986 that are due mainly to the new examination program.

The *St. Louis* District is adding to staff primarily in data processing and supervision to implement Systemwide programs.

Staff increases in the *Kansas City, Dallas,* and *San Francisco* Districts are the largest and are due to the significant impact on these western Districts of the new examination program. The Dallas and San Francisco Districts also have rapidly growing volumes in their currency and check operations.

Table 5.5 shows Reserve Bank employment in the various service lines and support and overhead activities.

For 1986, the largest budgeted increase is in supervision and regulation (11.4 percent, or 219 employees), mostly for field examiners. The increase in staff for services to the U.S. Treasury and government agencies (3.8 percent, or 67 employees) is accounted for by additions for the T-DAB system offset by reductions for other fiscal services. The increase for services to financial institutions and the public (1.3 percent, or 117 employees) is a response to an increase in the public's demand for currency in the western and southern Districts (which calls for 35 more staff members) and the combination of the program of notification of the return of large-dollar checks and expansion in the volume of check processing (108 additional staff). No change is planned for the monetary and economic policy service line after

5. For a description of the open-access cash policy see chapter 3, note 5.

6. Standard data processing environments permit the use of standard software applications by the Reserve Banks.

Table 5.5
Employment at the Federal Reserve Banks, in Selected Activities, 1984-86

Average number of personnel, except as noted

Type of activity	1984 Actual	1985 Estimate	1986 Budget	Percent change, 1985-86
Monetary and economic policy	826	813	813	0
Supervision and regulation [1]	1,885	1,918	2,137	11.4
Services to financial institutions and the public [2]	8,395	8,742	8,859	1.3
U.S. Treasury and government agencies	1,798	1,784	1,851	3.8
Support to output services				
Data processing	2,584	2,691	2,748	2.1
Occupancy [3]	1,292	1,280	1,271	− .1
Other	464	460	484	5.2
Overhead				
Protection	1,206	1,204	1,184	−1.7
Personnel	944	929	948	2.0
General books and budget and expense control	870	872	876	.5
Administration	813	689	683	− .9
Audit	402	401	408	1.7
System projects and System contingency processing center	215	310	319	2.9
Purchasing	267	271	276	1.8
Other [4]	707	711	685	−3.7
Total, all activities	**22,669**	**23,074**	**23,542**	**2.0**

1. Approximately 1,300 employees, mostly field examiners, are directly involved in supervision of financial institutions.
2. Nearly 60 percent of the staff—more than 5,000 employees—in services to financial institutions and the public are involved in check-processing operations; another 1,600 work in currency operations.
3. Building and housekeeping services.
4. Includes mail, legal, files and record storage, motor vehicles, library, and telephone operations.

a reduction of 13 employees in 1985. The increase in support to output services (1.6 percent, or 72 employees) lies mainly in data processing, to support the System's long-range automation plan and to maintain the computing capacity needed to support the expanding information and operating volume of the Reserve Banks. A small decrease is projected for overhead (0.1 percent, or 8 employees), as security devices have allowed a reduction of 20 ANP in guard forces while only small offsetting increases are budgeted for most other types of overhead and the rest show small declines.

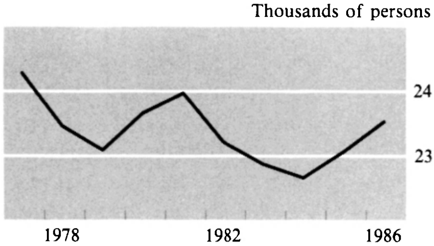
Trends in Reserve Bank Employment

Chart 5.1 depicts the trend in Reserve Bank employment as reflected in the budgets for the years 1977-86.

Over the past decade, total employment at the Reserve Banks has declined 758, or 3.1 percent. Employment reached its highest level in 1974, with 26,567 employees, and began a steady decline in 1975, which over the next five years brought the total down 3,463, or 13.0 percent. This decline resulted from a Systemwide program to increase efficiency and productivity through improved automation equipment and cost restraint. Reductions were made even as volumes processed continued to expand. (The growth in volume in the largest operating area, check processing, averaged 6.8 percent per year over this period.)

The efforts to contain costs and improve operations in fact positioned

Chart 5.1
Total Employment at the Federal Reserve Banks, 1977–86



the Federal Reserve to respond to the provisions of the Monetary Control Act.[7] By the same token, the Banks had few unused resources to devote to the new requirements. Thus resources had to be expanded: in 1980 and 1981, employment increased 2.5 percent and 3.2 percent respectively.

The pricing of services under MCA altered clearing patterns: in some service categories it caused losses of between 15 and 30 percent of volume. For example, in the check area (the operation of greatest impact on System trends inasmuch as it takes up about 31 percent of all Reserve Bank resources), volume processed at all Federal Reserve Banks in the first quarter of 1983 was about 20 percent below the level in the first quarter of 1981, before pricing. The volume of electronic funds transfers continued to grow but at a slower pace. The adjustment to the volume loss was swift: staff was reduced 559 in 1982, 347 in 1983, and 214 in 1984 to reach a decade low of 22,669.

In 1985, employment turned upward, increasing 405. Two-thirds of the increase, about 270 employees, came as the volume of priced services expanded and their quality improved. Because of the supervisory challenge in 1985, 50 employees were added in that service. To handle the needs of System automation and the generally increasing computing workload, data processing added about 100 employees. Offsetting these increases were decreases in monetary and economic policy (13), services to the U.S. Treasury and government agencies (14), and overhead services (37).

Employment is expected to turn upward again in 1986, as explained earlier in this chapter.

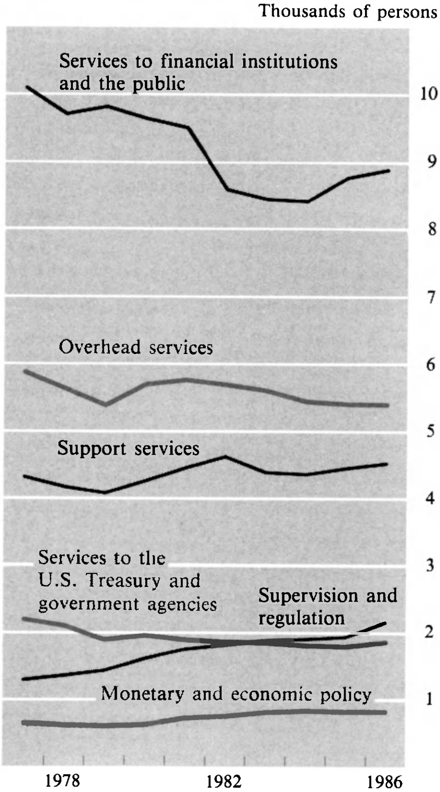
Trends in Reserve Bank Employment by Service Line

Chart 5.2 depicts long-term trends in Reserve Bank employment by service line. The impact of the MCA can be seen in the curve for monetary and economic policy for the years 1980 through 1983, as the burden of data reporting increased significantly. Since 1983, staffing in this service line has changed little. In services to the U.S. Treasury and government agencies, staffing has trended downward throughout the 10 years, with an increase in 1986 due to the T-DAB program. The sharp decline in employment in services to financial institutions and the public in 1981 and 1982 reflects the adjustment to pricing and the associated drop in volume. Overall, this service line is down more than 1,200 employees from its 1977 level. Staff in supervision and regulation has increased steadily over the period because of the increased burden of supervising District financial institutions, as previously discussed. Staff in support services has grown moderately over the period, mainly because the volume of data

7. See chapter 2 for a discussion of the requirements of the MCA.

Chart 5.2

Employment at the Federal Reserve Banks, by Service Line, 1977–86



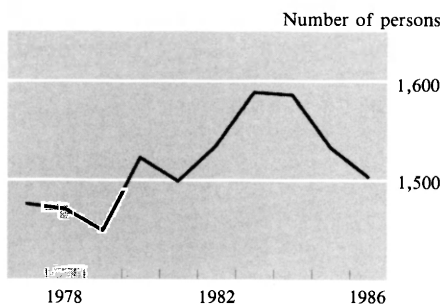
processing has expanded. The number of people in overhead services has trended downward since 1981 and is expected to be about 480 lower in 1986 than in 1977.

Trends in Board Employment

For the most part the long-term employment pattern at the Board follows that of the Banks, as a comparison of charts 5.1 and 5.3 suggests. From 1977 to 1980, the patterns are similar: the Board's workforce declined slightly from 1977 to 1979 but rose sharply in 1980 in response to the requirements of the Monetary Control Act. The year 1981 saw the effects of the Board's program to meet additional staffing needs in areas affected by the MCA and to reduce positions by eliminating work of lower priority. Employment rose slightly in 1982 and again in 1983 as workloads increased. The sharp downward trend thereafter reflects successful efforts to streamline functions and to enhance productivity through automation.

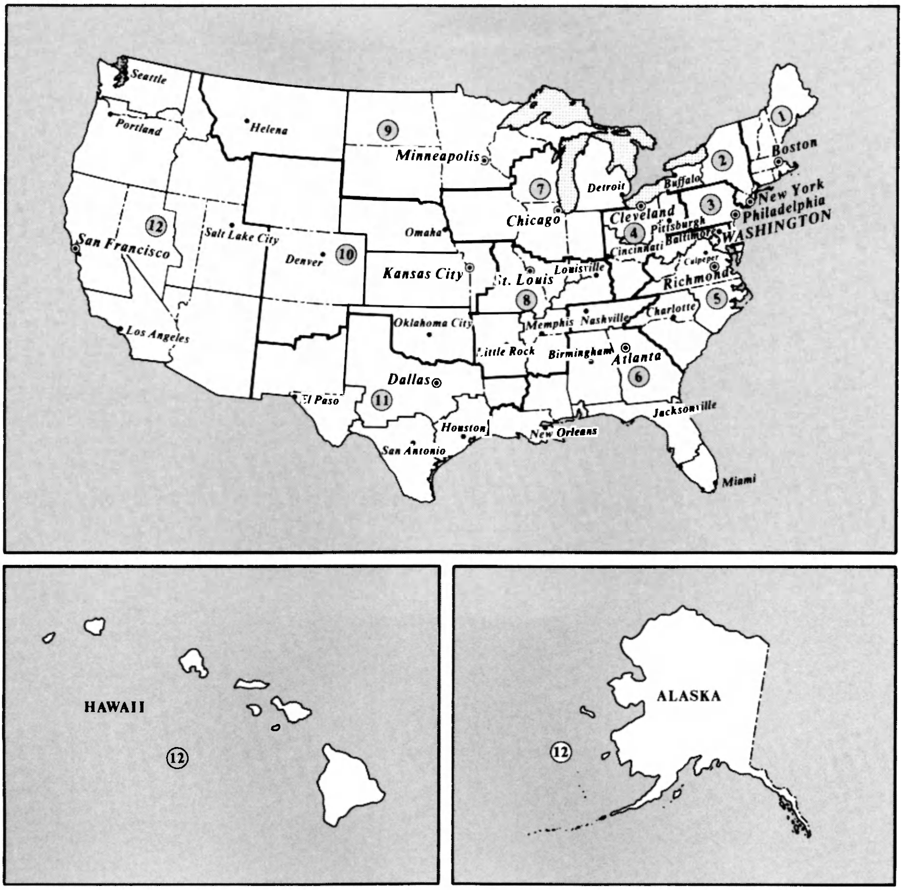
Chart 5.3

Employment at the Federal Reserve Board, 1977–86



The Federal Reserve System

Boundaries of Federal Reserve Districts and their Branch Territories



Legend

—— Boundaries of Federal Reserve Districts
—— Boundaries of Federal Reserve Branch Territories
- Board of Governors of the Federal Reserve System
- Federal Reserve Bank Cities
- Federal Reserve Branch Cities
- Federal Reserve Bank Facilities

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