Summary of Remarks of
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My comments are specifically directed at assessing the monetary consequences of transforming deposits in savings and loan associations and mutual savings banks into money. This would be accomplished by permitting savings depositors in these institutions to write checks on their deposits or, in a more limited application, to make credit transfers to other depositors in the same institution. It is assumed, of course, that the transformation of savings into money would take place without such deposits becoming subject to the reserve requirements imposed by the Federal Reserve on commercial bank demand deposits.

Put this way, both equity and effective monetary control would seem to require that the rules presently in force for demand deposits in commercial banks should become applicable to mutual savings banks and savings and loan associations.

The demand deposit component of our $220 billion money stock is now about $170 billion (coin and currency amount to $50 billion). Deposits at mutual savings banks are about $74 billion and saving capital at savings and loan associations is about $152 billion. The idea of doubling the present money supply of approximately

\$220 billion by adding \$225 billion of savings accounts in mutual savings banks and savings and loan associations is, at first exposure, an unthinkably inflationary thought. It would undoubtedly be a major catastrophe for U.S. monetarists and their followers whose correlations of M_1 would become worthless as guides and evidence of future monetary action. Such a situation would be even more frustrating for some monetary analysts than that which arose when ceiling regulations on time deposits produced ebbs and flows of intermediation which recently have often vitiated M_2's usefulness as a monetary guide.

On the other hand, to take a calmer view, except for the competitive climate between banks and other depository institutions, not much else would necessarily change if savings deposits became money. People would not, because their savings accounts could be used to pay household bills, spend more or less, and the liquidity position of small savers probably would not be significantly changed. If the terms of fixed maturity time deposits were not disturbed market interest rates should not be much affected, nor would the flow of funds be likely to change in tempo or volume.

Before assessing the problems caused the monetary authorities or the monetarists by such a broadening of the money supply, it would be helpful to consider how such a proposal might be implemented, and how money is subject to central bank control.

Money is a term that is almost as loosely used as it is sometimes spent. In our newspapers today full page ads identify bank credit cards, nonbank credit cards and travelers' checks as money. None of these instruments is subject to the Federal Reserve's reserve requirements today and none of them is money, either, except in the sense of some copywriter's license to convert similiarities into identities. Money is coin and currency in circulation and demand deposits of commercial banks other than those due to domestic commercial banks and the U.S. government.

Not all money so precisely defined is directly subject to the Federal reserve requirements, notably demand deposits in nonmember banks. There is, to that extent, a precedent for exempting other depository institutions from such requirements--i.e., if one is prepared to argue that a leaky boat is no less safe if another leak or two is added. It so happens that the nonmember bank component of the money supply has grown steadily in relative importance throughout the 1960's. It was a little over 14 per cent of the money supply at the beginning of the Sixties and rose to 18 per cent in 1970. More significantly, nonmember deposits have consistently shown a sluggish response to monetary restraint. In 1966 and 1969, for example, the nonmember banks added more to the money supply than did member banks even though member bank shares of the money supply were, respectively, four and three times as large as those of nonmembers.

Without being too technical or too elementary, I'll assume we could agree that among the conventional tools of monetary action in the United States the ability to change reserve requirements is not essential. Desirable and convenient in certain circumstances, yes, but not absolutely indispensible. We could go it alone with open market operations, or open market operations and discounting. But to do so would place a heavier burden on financial markets and would forfeit the advantages of immediacy and pervasiveness inherent in a general change in reserve requirements. These are not unimportant considerations; they cannot be duplicated by other tools.

There is no way of knowing the point at which changes in reserve requirements would cease to be an effective monetary tool as the reserve base shrinks. Commercial banks now are reacting to significant cost disadvantages inherent in membership in the Federal Reserve System, and there is not only a steady attrition in System membership but, more importantly, a steady growth in the number of larger and larger banks outside of the System. This trend should be reversed: it would have been better if non-member bank shares of money supply had declined from 14 to 10 per cent in the past decade instead of increasing from 14 to 18 per cent.

Adding another exempt category of depository institutions might not significantly weaken monetary control but it would surely weaken the case for using reserve requirements as a monetary tool. Moreover, it would certainly strengthen the case for experimentation with untried monetary tools. Perhaps this experimentation is needed. But it would also reinforce the case for depository rate ceilings, and regulatory credit controls over the access of banks and other depository institutions to money and credit markets. I am less persuaded these measures should be encouraged or extended.

The way in which any monetary tool works is not fully understood in the sense that we know the linkages or exactly how much reserve input will produce how much change in the economy's spending and investing, and when. And some monetarists say we don't need to know, referring us to regressions. But we do know that as the System changes the rate at which it supplies funds through open market operations or otherwise, changes in money market conditions, investor expectations, interest rates and credit flows ensue. These changes, as they work through financial markets, even though they may start with member banks, affect all kinds of financial intermediaries. Who here does not remember the financial pangs of 1966, and how general they were in the financial world.

I think we must all agree that monetary restraint is not a condition uniquely affecting banks, member banks, or even money market banks. Banks, generally, may be in the front line--and some in the vanguard--but other financial institutions are not far behind. Undoubtedly banks, savings and loan associations, insurance companies and other types of financial institutions are, by their nature, diversely affected by monetary restraint but the investment policy of each institution is also a very important element differentiating their exposure. Large holdings of non-earning assets and short-dated debt cushion the onset of monetary restraint. Of course, cushions are not costless especially if the central bank seems poised to strike over a long period of time. The more venturesome--i.e., the fully invested--institutions, of whatever type, really become the leading edge of monetary restraint for they have the shortest time to adjust their investing and lending terms and are affected by even a modest change in interest rates and money flows.

A word may be needed on the economization of demand deposit balances, a trend which has been going on for some time, as most of you have noted at first hand. Since 1964, total transactions by check have roughly doubled--9 trillion per year compared to almost 18 trillion in 1970. Money supply has not doubled by any means in these six years: it has increased less than 40 per cent. More active use of balances has made the difference: turnover doubled in New York, increased 85 per cent in six other money centers, and elsewhere rose about 40 per cent.

Our experience with acceleration in money payment has not given the central bank problems of monetary management up to now. In fact, the Federal Reserve is encouraging the adoption of techniques to expedite money payments. I do not foresee that we will wind up in a monetary cyclotron with salaries, rent, and credit card chits being paid hourly in milli seconds, but if we were to, I doubt it would raise any serious problem of monetary control.

Monetary restraint does not work efficiently if it creates a payments crisis; it is most effective as it impinges on future spending and investment plans. Thus, monetary effectiveness is a matter of changing the liquidity position of households, businesses and financial institutions and not of stopping in its tracks money settlement for previous commitments.

I have been sketching in a very general way the consequences of putting savings institutions into the demand deposit business. It, of course, makes a great deal of difference, so far as monetary control is concerned, how this might be done and the extent to which savings aggregates are incorporated into some such system.

There are many aspects of the general proposal to use savings accounts as money other than the effects on monetary control. Indeed, until details are specified and effects on depository institutions and their customers are known and the effect on the money payments system can be appraised, the monetary impact cannot be adequately assessed. If, for example, such payments were limited to so-called third party transfers the potential for a practical and useful improvement in our monetary system and mechanism seems to me to be fully capable of realization with very limited exposure to monetary effectiveness.

The idea of permitting a commercial bank, a mutual savings bank, a savings and loan association or a credit union to transfer funds from one to another of its deposit customers hardly seems an earth-shaking innovation. Yet some obvious innovations initiate a line of development that is revolutionary. This one is about as simple a record-keeping transaction as can be imagined. For the depositor who authorizes the institution to charge his account and to transfer a specified amount to another account, it is the ultimate in money convenience. For the depository institution, there are several advantages: the transaction can be under continuous internal surveillance; no funds are drained away, no float is absorbed, no outside transfer requirements are imposed, the money position becomes more stable and a new service has the potential of attracting additional customers. For the central bank, it would introduce a new category of demand deposits which should include similarly qualified accounts in all types of depository institutions. That is, all institutions offering such a service should be subject to the same level and change in reserve requirements. The broadening of the narrowly defined money supply would, I believe, sharpen the usefulness of this aggregate by incorporating into it the major source of liquidity for the household sector.

The concept of third party transfers--since it has yet to be incorporated into a law or regulation--has not been sufficiently defined to avoid misinterpretations or understandings of its merits or disadvantages. For clarity's sake, I refer to such transactions as credit transfers. A debit transfer, in contrast, takes the form of a conventional check which is the bank's authority to charge a customer's account. A credit transfer would occur when the customer, by prior agreement or specific instruction to his institution, directed it to transfer funds from his account to another customer's account.

Thus a third party credit-type transfer would not result in a negotiable instrument, such as the check, but would be based on a contractual agreement between the bank and its customers. The agreement might be flexible enough so that the bank was authorized to charge the customer's account without specific prior notice for mortgage, utility and other repetitive payments for known, or approximately known, amounts. The arrangement suggested for savings and loan associations--and perhaps other depository institutions--would limit transfers to those between customers of the same institution.

In conclusion, but more as an aside from my specific topic, as I have reflected on the banking industry's reaction to the efforts of the savings and loan associations and the mutual savings banks to get into the money business I have wondered about its wisdom. Hasn't it been too negative in its implications for the public interest and for the industry itself? The encouragement of third party transfers would clearly, in my opinion, add greatly to the public convenience, especially that part of the public whose cash and liquidity resources are limited. Any technique which adds to the convenience and reduces the costs for these depository customers should be encouraged.

As a matter of equity, and monetary efficiency, I would urge that any depository institution going into the money business should be required to treat accounts eligible for third party transfers as demand deposits. But the equity and public benefit argument does not end there. Banks ought to have the right to offer third party transfer service to their saving deposit customers with $100 billion in deposits on the same terms as savings and loan associations--say, at a reserve requirement somewhat higher than savings accounts not eligible for such transfers.

According to the FDIC's latest survey of deposits (June 1970) there are 69.6 million demand deposit accounts with balances of less than $1,000 (the total number of such accounts is 86.6 million). There are 58.6 million bank saving accounts with balances of less than $1,000. The overlapping of accounts is substantial and there are several million of these depositors who could manage conveniently on a single savings account with third-party transfer privileges. Why shouldn't the industry be exploring this opportunity for improved service to millions of its customers?