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THE BALL IS IN YOUR COURT

Remarks of

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at the

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Over the past few months the Federal Reserve, the Banking Committees of Congress and the financial industry have been seeking an accommodation to solve the various problems associated with monetary control, membership, equity in reserves, and pricing and access. By narrow votes various alternatives failed to pass in a House Banking Committee markup session and the search for an acceptable alternative continues. What have we learned in this experience?

First, it is unfortunately more difficult to sponsor new legislation than to block legislation someone else is proposing. The banking industry and its regulators have staved off a number of pieces of unwise legislation over the past 20 years, but we have sponsored very little new structural reform and much of it failed. Obviously the "turf protection" syndrome is alive and well, and financial statesmanship is not yet the order of the day.

Second, we have learned that there is a politically practical dimension to new legislation. The lack of sufficient votes to pass uniform universal reserve requirements mandatory to all depository institutions is a clear reflection of the political power of various groups. Without a demonstrated crisis, there is a notable lack of urgency to the participants. Perhaps it is testimony to our inability to communicate the serious nature of the problem and the need for prompt relief, but perhaps it may also be a lack of recognition of the political feasibility

by some groups. Let me be specific. From my vantage point if the banks believe the Federal Reserve will unilaterally pay interest on reserves, given the Congressional attitudes demonstrated these past few months, I think you should reappraise your position. I see little sympathy for such an action without Congressional approval.

Third, we learned that the negotiation process to line up support for an acceptable solution often involves compromises almost incompatible with prior positions and brings with them a charge of uncertainty or lack of conviction. We are probably naive in our legislative effort and may be unschooled in the methods needed to develop a consensus position, but we have demonstrated our good intentions and willingness to listen.

Fourth, we have learned that new initiatives to resolve conflict must rest with those who oppose the proposed solutions. I see little point in the Federal Reserve making continuously new propositions when the groups opposing our prior efforts are as divided as shown by the recent votes. It seems to me that if this is a problem to be solved and one which will only get worse, then new initiatives must come from the affected participants who seek a different solution. This position relates to those in disagreement wherever they are located, as you will see at a later point.

Finally, we learned that when all is said and done, each will advocate a position he sees as most advantageous to his own financial

well being in the short run. To get people to act voluntarily against their own pocketbook is very difficult but to get them to act simultaneously for a long-range public good is extraordinarily complicated.

H.R.7 had elements of exemption levels, indexing, and mandatory reserves which many opposed but the fundamental thrust of universal coverage had an almost overriding attraction. The issues separating the affected groups seem to fall into four primary areas.

1. Mandatory versus voluntary maintenance of sterile reserves at the Federal Reserve.
2. Inclusion of nonbank intermediaries.
3. Payment of interest on reserves against the Congressional demand for severe limits on loss of Treasury revenue.
4. Coverage of time and savings accounts.

It is within these areas that a compromise must be found or membership withdrawals will accelerate and a crisis precipitated. I do not mean to lead you through a reappraisal today, but would like to point out a few fundamental facts.

First, if the banking system wants to equalize its position with the nonbank intermediaries, a mandatory solution covering all depository institutions seems most likely and now is the time to achieve this at least for the deposits where new bank-type powers are being offered by thrifts. Also if the reserve base can be enlarged then the level of reserve requirements can be lowered without significant Treasury loss.

Second, banks cannot expect other depositaries to be covered unless all banks are covered. Exemptions for upwards of three quarters of the banks can scarcely be a demonstration of good faith and commitment to universal reserves.

Third, either by exemption or by a do-nothing erosion, the banking industry will be fractionated into the very largest against all others. Such a position will place the large banks in a "sitting-duck" role for any new punitive legislative or administrative limits. Similarly the smaller institutions lose the protection of the lender-of-last-resort and must again rely upon correspondent bank strength, viability and willingness to meet emergency needs. Having experienced significant problems with such an arrangement before I see little reason to reproduce it.

Finally, one could wonder with some justification whether legislation born of a crisis would be as acceptable as a law well discussed and negotiated in advance. If the process of seeking the most acceptable but politically feasible solution were to break down, then ultimately a crisis would seem likely. I doubt if that is in anyone's true interest.

Thus "the ball is in your court." Serve up something which will meet the imperatives of the situation--a resolution of the conflicts with a positive contribution toward policy control, membership, equity, and simplicity. From my standpoint, reserve coverage of at least the transactions accounts at all banks is an imperative. You have your own imperatives, but build your solution to encompass them all.

Each of the protestants whether as a group or individually has a responsibility to reflect on the problem and suggest a solution. As one who objected to the exemptions in H.R.7, I meet this responsibility by suggesting a three-part solution: first, required reserves on all depository transactions accounts differentiated by size of deposits in a manner similar to the present structure; second, voluntary membership which would still require reserves on short-term time and savings accounts, but with such reserves serving as clearing balances and a return offered through implicit pricing; third, requiring nonmembers to have clearing balances and pay explicit prices for services. Now it is your turn. I hope you come up with an even better solution.

In closing let me say a few words about pricing and access. We have received comments on our check pricing proposal ranging from too high to too low, from too much overhead to too little coverage of profit and taxes, and from inadequate attention to service levels to no coverage of float. I should tell you that we are working hard to reduce float rather than charge for it, and this may change a few minds as to the value of correspondent service levels. It may also shift the balance of return on correspondent accounts.

We are continuing our study on prices for other services such as wire transfer and currency and coin, but for each service there are new problems to be faced. For example, we question the desirability of district pricing for a nationwide service such as wire transfer and we question the degree of pricing to be assigned to a governmental service

like currency and coin where a large profit already inures to the sovereign. I suspect that we may even discontinue offering some services rather than price them.

The pricing effort still holds many of the problems we have talked about before. We do not see the wisdom of implementing pricing until the burden of membership is alleviated. Also we cannot recommend prices which cause a large and immediate shift of volume to or from the Federal Reserve and we believe that our prices should be constructed in such a way as to protect small and remotely located banks. The eleven percent surcharge is, we believe, an appropriate approximation of the profit and capital costs of a comparable public utility.

Regarding access we still think that opening the Federal Reserve services to all depository institutions would be desirable only with both pricing and equitable reserve treatment for all.

Some of the newer questions concerning the payments mechanism revolve around ACH pricing and procedures. Frankly I think we should be working toward prompt truncation of checks and developing an electronic delivery system. We have asked our staff to accelerate their efforts in these fields and hope that you will do likewise. I believe it would be to our mutual benefit to reduce check payments, cut down on courier distribution, and minimize return items.

As we in the Federal Reserve work on these various problems we hope that the industry will dedicate its best talents to the solutions.

Our goals for 1979 should include completion of a new structure of reserve requirements conducive to effective monetary control, settlement of the membership problem on an equitable basis, and emphasis on a modern competitive financial system with a full-scale electronic payments mechanism.

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