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Everybody's Problem--The Movement of Money

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The last step in most economic transactions is a money payment, an act "finalizing" all preceding negotiations and decisions. Essential as it is to the consummation of a transaction, payment is little more than a ceremonial act so far as business acumen and commercial expertise is concerned.

But money payments are not ceremonial acts so far as the Federal Reserve, the Treasury, the Federal Deposit Insurance Corporation and the commercial banking system are concerned. These institutions have the major responsibility for providing efficient, certain and expeditious facilities for the transfer of money. And the fact that money payments can be regarded as a rite of sorts is a credit to the skill with which these authorities and institutions have facilitated the whole process.

Methods of money payment have changed rather slowly even in modern times but accelerating technology and innovation in data processing and transmission are making new money techniques possible--if not necessary--to parallel the developments in electronic record keeping.

Institutions who make money their business are confronted with some hard decisions whenever any change in the nature and the methods of using money are proposed. New techniques almost always mean new problems, not the least of which is that of winning public acceptance. Faced with the difficulty of selling a new product, even though it is more economical and efficient, some money technicians

prefer to avoid change, even though the alternative is a money form becoming more and more of an anachronism. However, new money forms and techniques can be introduced without displacing existing types and public acceptance will determine their role on the basis of comparative cost, efficiency and convenience.

More efficient forms of money or techniques of money payment are resisted in some quarters because they may do the job too well. As in any case where a new technology threatens to displace another, even gradually, there is a natural resistance to giving up established advantages, however less efficient they may be. The technical shortcomings of check money, for example, whether adapted with technical legitimacy to non-par bank clearing, or illegitimately, as in a check-kiting operation, have long detracted from the reality of a sound and certain money. The delays and uncertain timing of check transfers more pervasively belie the claim that such money is as convenient and certain as money can be made. The full nature and extent of the vested interests in the retention of the present checking, coin and currency system are well beyond my time, knowledge or imagination simply to list. It will suffice my purpose, today, to call to your mind one family of such interests with a single word--float.

One of the well known features of payment by check is that it does not result in an immediate cash transfer, as in the case of coin or currency. A check entitles the payee to institute through

his bank a series of bookkeeping transactions which will ultimately--if the payor's balance is sufficient--transfer funds into his account on some future and somewhat uncertain date. The payee's bank may give him immediate credit even if a check is on a remote bank, particularly if the average size of his account warrants a short-term interest-free loan, but it will not itself receive the funds until a scheduled period has elapsed, during which time most items are presumed to be payable. And if, in fact, the schedule is not achieved the Federal Reserve extends a substantial amount of interest-free credit to banks--some \$2.5 billion worth, in fact--to take care of imperfections in the schedule as well as processing, weather, transportation and other delays.

Check payment thus has elements of uncertainty and delay which some individuals, corporations and banks in their capacities as payors have regarded as a significant advantage. Using float--items in the process of collection--as an operating balance is a common practice for those who manage their accounts closely. It may result in a net gain or it may simply offset the delays in the receipt of funds which reflect the close management of their debtors' bank balances. We have to assume that people and institutions who go to all the trouble to minimize their money holdings find a significant economic advantage in doing so. However, they may not be toting up the costs they bear in deferred receipt of credits to their account because of the prevalence of such a practice. There probably are some institutions and individuals so situated in their economic relationship as not to be vulnerable to deferred credit although they can gain from mail or Federal Reserve float.

The institutionalizing of the presumed advantages of float, of whatever nature, accounts for some of the inertia, if not resistance, to expediting money payments and making their timing certain. But only in a chimerical world should we, as individuals, businesses or banks, expect to be paid in Federal funds, coin or currency, and to pay others with checks on banks in locations without air, rail or bus service.

The Federal Reserve System has operated, since 1922, a money transfer system that, along with Western Union wire transfers, is unique for the United States. Both resemble the European giro systems in that they involve credit transfers. The check is the authority to debit or draw down a bank account and is, therefore, a debit transfer. Transfers on the Federal Reserve wire network are initiated by an instrument authorizing the Federal Reserve to credit the account of another bank or some account within that bank. As a payments device the credit transfer is superior in several respects--payors and payees deal only with their own bank; payors direct their banks when and to whom they want transfers made. Payees are advised by their banks when and from whom credits have been received. All transactions are within the technological and processing safeguards and efficiencies of the banking system. No transfers are initiated unless the funds are on hand, no endorsements are required, there is no float. The technique lends itself to electronic processing.

In the Federal Reserve this wire network is used mainly for the transfer of funds and Government securities between member banks. It now handles two million or more money payments a year. Another two million transfers are handled by the Federal Reserve Banks within their individual districts. Most of these transactions are for large amounts; custom has restricted the service to bank transactions.

We have found credit transfers to be an efficient, safe and certain method of moving money. All that is required is an instruction from a member bank to its Reserve Bank, directing that the amount in question be transferred from its account to the account of another member bank. Third parties may be named, which makes possible the movement of a payment from the account of a company or an individual to another account anywhere in the country.

Minor impediments exist: a small service charge (\$1.50 per transaction) is made if a party other than a member bank is named, or if the amount is other than in thousands of dollars. Also, some delays are experienced during peak hours of the day. Both of these difficulties should be eliminated next year when new equipment will have been installed in all Federal Reserve offices. The system will open business at 16 times the capacity of our present leased wire facility. It can be expanded to handle 250,000 payments an hour.

The new electronic gear now being installed is the result of five years of intensive planning to meet the growing volume of money movements. Its primary function will be the simultaneous

debiting and crediting of accounts among all member banks in the nation. It will consist of a national communications grid, serving all Federal Reserve Banks and Branches and the Board of Governors, centering in an electronic switching center located in a protected site at Culpeper, Virginia. It will contain both low and high speed lines, and will tie together a wide variety of terminals, ranging from teletypes to on-line computers. The switch is of the most advanced design we could find. It is adaptable to changing forms of payment as they may evolve.

The system is peculiar in the sense that additional switches can be added at the Culpeper site, or more likely at other locations in the United States, to handle growing volume--in other words, this national grid can be expanded almost indefinitely.

In addition to the nationwide facility, individual Federal Reserve Banks are setting up local switches to handle transactions within their own districts. Some of these will, in time, be as large as the Culpeper switch. A prime objective of these Federal Reserve Bank switches will be the ability to accept automated communications from their member banks. Thus, a payment will move from a bank in Chicago to one in New York in completely automated fashion, and in a matter of seconds. Installation targets for two of the Reserve Banks, New York and Chicago, are in 1970.

It would be incongruous to have in place and operational a money transfer system that moved funds expeditiously from New York

to Chicago or San Francisco but could not provide comparable efficiency in funds movement within metropolitan areas where existing clearing house arrangements have limited geographical coverage. The System, therefore, is encouraging the expansion of local area clearing arrangements. The most important of these-- in fact a new step for the System--is the so-called Washington-Baltimore-Northern Virginia clearing center, to be located at the Baltimore Branch of the Federal Reserve Bank of Richmond, and to service some 90 banking institutions.

By its planning and action in putting into place a sizable electronic transfer plant and related staff the Federal Reserve System is demonstrating its preparedness to accommodate an automated payment system as rapidly as it earns public acceptance.

What are commercial banks doing to ready their operations for expanded reliance on automation? Virtually every bank whose operations are large enough to justify a computer facility has converted its check processing and demand deposit accounting to automated equipment. Smaller banks are using the facilities of their correspondents and/or service bureaus. While this equipment is used to process checks it is equally capable of handling credit transfers. Many banks are offering special techniques to speed check collection, such as lock box service. Some expect to serve their customers more efficiently with computerized preauthorized debit plans and payroll crediting arrangements. And now we have the bank credit card fully established in many institutions and finding its way to universal acceptance. It will also serve, I believe, as a cash transfer card

as soon as consumers are offered some incentive for immediate payment.

Individual banks clearly have been moving innovatively to reduce costs and add to customer services with the new technology. But some changes in money and money techniques are not feasible for an individual bank. They require collective action by banks and other institutions. Here much planning progress is under way. Regional banking groups are active. California's SCOPE (Special Committee on Paperless Entries), for example, has a remarkable program in promise and precedent. It hopes to substitute magnetic tapes for checks to meet payroll, utility, premium, dividend, rental and similar repetitive payments. The MAPS (Monetary and Payments System Committee), a committee of the American Bankers Association, has a comprehensive study and intensive planning program looking into the economic, technological, legal, and marketing aspects of new money techniques.

Meanwhile, what do bank customers need to do to prepare for an orderly transition to a money system compatible with electronic accounting and data processing? Assuming that many changes in the present system will be involved, as I do, large money users need a cost-benefit evaluation of various techniques now becoming available-- the Federal Reserve credit transfer, the credit card, the pre-authorized debit, the payroll crediting arrangements, etc. What are present money transfer costs and efficiencies compared with those likely to be associated with some combination of the new techniques available and becoming available? If such evaluations are favorable to change,

business customers of banks will, I am sure, find many banks ready with established programs or with plans that can be implemented.

Your evaluation will, of course, have taken into account your cost in any of these new arrangements. Unfortunately, the total costs of our money transfer system are spread throughout the economy in the form of payments for the minting, printing, transportation and storage of money and checks, police protection, insurance against theft and embezzlement, safes and vaults, equipment, clerical and supervisory payroll, supplies and overhead, to mention some of the more obvious items. These costs are dispersed among businesses, individuals, banks and Government. If we could total them all up I am sure the overall savings of a basic electronic system would be impressive. Savings probably would be significant for some private sectors too.

The benefits to business may be easier to visualize. If, for example, you were able to convert all or the bulk of your payroll, supplier, financial and dividend payments to credit transfers, your bank would do many of the operations you do now, faster and with greater certainty. Having supplied it with a magnetic tape identifying payees, amounts, and the times for payment the bank would carry out the rest of the transaction. Such a service would be far and away superior to that provided by the present check system and should be something for which your bank ought to be able to collect a "pretty penny."