1976 ANNUAL REPORT

FEDERAL RESERVE BANK OF CHICAGO

Foreword

The year just past has been memorable for the American people. The Bicentennial was, all in all, a good year. It was a year of fresh insights and rediscovery. It was a year during which Americans had the opportunity—and the motivation—to reflect upon the roots of their society, to consider their past. And in thinking about their origins, Americans were provided with some new perspectives on where they might and ought to be going.

In particular—and quite naturally so—the institutional framework of the American system of government was in the spotlight during 1976. Americans looked at their governmental system and were reminded how unique it is—not only in its peculiar institutional arrangements but in its relative longevity as the cornerstone of a democratic society. They retraced that system to its origins and found them in the philosophies and hopes and even in the fears and suspicions of the founding fathers. They discovered that even though the nation's circumstances have changed dramatically in the past 200 years, the aspirations of the nation's people have remained surprisingly constant. And the American people found in the end that the underlying framework of their public institutions still serves them rather well, even if the performance of those institutions can be found wanting from time to time.

It is in this same spirit that we at the Federal Reserve Bank of Chicago have taken the opportunity provided by our 1976 Annual Report to reflect momentarily on the structure of one of our public institutions—the Federal Reserve System—before turning to the Chicago Fed's performance, as one component of that structure, during the past year. Our primary aim is not really to describe the rather unusual structure of the nation's central banking system, but rather to place that structure in a perspective that makes it somewhat more understandable. And even more importantly, it is hoped that by putting the Fed's structure in the context of the past, some focus can be provided for current discussion of whether that structure can continue to meet the nation's needs for the future.

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The Fed in perspective: 1776-1976

The Federal Reserve System—two hundred years old? Obviously not. It was "born" in this century; only some sixty-odd years have passed since President Woodrow Wilson signed the Federal Reserve Act. Nevertheless, the Fed of 1914—the year it was established—and, indeed, the Fed of today is as much a reflection of the philosophies expressed in the structuring of the American republic as it is a creature of early twentieth-century American experience.

Without viewing the Fed in such a perspective, one that transcends its own lifespan, it is almost impossible to make sense of its many unusual—indeed unique—characteristics: the fact that although the Fed is the U.S. central bank, its structure is basically decentralized; the fact that although it is a public institution, with a public purpose, the Federal Reserve Banks which carry out this purpose are strikingly private in form; the fact that although all Fed operations are aimed at serving the public as a whole, direct dealings with the public at large are limited compared to interactions with firms within the private sector; and finally, the fact that although the Fed is without doubt a governmental agency, its operations are largely independent from the government.

These truly unusual features in the Federal Reserve's structure cannot be explained solely by the economic circumstances at the time of the Fed's establishment. In fact, even the whole of U.S. history, including the rise and fall of the country's two previous central banks, cannot adequately explain the Fed's "split personality." (See Box.) To truly make sense out of this unique central bank, one must look beyond American historical events—one must look to the uniquely American ideas and philsophies that shaped the nation's history.

The "key" to the Fed's structure. . .

In his Farewell Address, George Washington warned of "... that love of power, and proneness to abuse it, which predominates in the human heart." He went on,

> The necessity of reciprocal checks in the exercise of political power; by dividing and distributing it into different depositories, and constituting each the Guardian of the Public Weal against invasions by the others, has been evinced by experiments ancient and modern;—some of them in our country and under our own eyes. To preserve them must be as necessary as to institute them.

These sentiments are fundamental to our system of government. While the founding fathers most certainly displayed abundant optimism in launching the "great American experiment" and in creating institutions to fulfill their hopes for the future, it was their abiding pessimism that government power could "forge the fetters for freedom" that determined their approach to those institutions.

In the eyes of the founding fathers, only a fine line separated the exercise of power and the abuse of power. To avoid creating concentrations of power, to assure that this line would not be crossed, they created a governmental structure with built-in limits on power—a system of "checks and balances." Not only was the latitude of each branch of the federal government to exercise power sharply restricted by the powers granted to the others, the power granted to the national government as a whole was circumscribed. It was a federal rather than a central government that was established, a government that could exercise only those powers specifically

The "split personality" of the Fed

The Federal Reserve is a central bank but it is decentralized:

Instead of a single central bank, there are 12 regional Reserve Banks. The operations of each, while coordinated through the System's Board of Governors, are to a significant degree autonomous from those of the others. Moreover, the Fed's relationship to the commercial banking system is strangely dichotomous for a central monetary authority since it is individual commercial banks that exercise the option of membership in the Federal Reserve. Perhaps most interestingly, authority for each of the central bank's primary policy tools (reserve requirements, discount rates, open market operations) is vested in a different component within the System.

The Fed is a public institution with a public purpose, but many of its characteristics are more typical of a private organization:

Like any public institution the Fed can be reduced to a singular purpose: promoting the well-being of the nation's people. Specifically, the Fed pursues economic stability and growth, high employment and stable prices, both domestic and international, through its power to influence the flow of money and credit in the nation's economy. But while its substance is wholly public, the Fed's form is strikingly private. Reserve Banks have corporate charters, private "stockholders," and directors representing the "stockholders" who elect them. And while the Fed operates for the purpose of serving the public at large, many of its operations represent service to a particular industry (commercial banking) within the private sector and even parallel services offered by firms within the private sector.

enumerated, with any other powers remaining the preserve of the various states.

Striking parallels to the concerns raised by Washington can be found in thoughts expressed at the time plans for the nation's third central bank, ultimately the Federal Reserve System, were being discussed:

> We must devise a plan, suited to the democratic genius of our government, which will save us from a dominating, powerful, centralized monetary institution.[1]

> The plan gives to the future central organ sufficient powers to render it efficient but at the same time restricts the functions of the central organ so that no possible danger of abuse in dealing with individual concerns or of interfering with the business of the existing banks, need be apprehended.[2]

> It seems to me that he has avoided the prejudice felt against a central bank, while safeguarding the proposed reserve association from becoming a political football.[3]

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[1]J. Laurence Laughlin, *The Federal Reserve Act, Its Origins and Problems* (New York: Macmillian Co., 1933) p. 389. Speech delivered in Chicago on May 24, 1911 by J.L. Laughlin, Professor of Political Economy at the University of Chicago and Chairman of the Executive Committee of the National Citizens' League for the Promotion of a Sound Banking System.

[2]*New York Times*, 18 January 1911, p. 5. Statement (in reference to the Aldrich plan) of Paul M. Warburg, partner in the New York banking firm of Kuhn, Loeb and Company. In 1914 Mr. Warburg was appointed to the first Federal Reserve Board.

[3]*Chicago Daily Tribune*, 18 January 1911, p. 6. Statement (in reference to the Aldrich plan) of George M. Reynolds, President, Continental and Commercial National Bank, Chicago. From 1914 Mr. Reynolds served almost 20 years on the Board of Directors of the Federal Reserve Bank of Chicago.

The Fed is a component of the governmental structure, but in large part it operates independently of the government:

Like any other government agency, the Fed is the creation of a legislative act, and just as Congress established it, Congress could modify or even abolish the Fed as it sees fit. Like officials of other government agencies, the members of the Federal Reserve's Board of Governors are appointed by the President with the advice and consent of the Senate, and report to Congress periodically on the performance of the agency they administer. But despite these clear ties to government, the Fed's degree of independence from government—especially on a day-to-day basis—is almost unique, not only among American government agencies, but among most central banks in the world. Underlying the Fed's independent posture within government are the facts that:

- The Fed is not subject to Congress's "power of the purse"—it operates on its own earnings rather than federal budget appropriations, and it need not seek Congress's prior approval for its actions and programs (so long, of course, as they are consistent with the Federal Reserve Act).
- The Fed, in formulating and executing national monetary policy, is institutionally separated from all other components of the federal government that exercise responsibility in the economic policy area. In particular, and in sharp contrast to many other central banks, the Fed is not an agency within the executive branch's finance ministry, i.e., our Treasury Department.
- The Fed's governmentally appointed officials serve 14-year terms, terms longer than those of the elected officials who choose them. In addition, the power to appoint many other Fed officials largely resides in the private sector.

The "prejudice felt against a central bank" was the natural outgrowth of the American view of man's propensity to abuse power. The fear of a "dominating, powerful, centralized monetary institution" was endemic given the American's suspicion of central authority of any kind.

It was these fears and suspicions that were expressed by the Jeffersonians—that creating an institution which concentrated economic power in the hands of a few would be tantamount to granting it the power to destroy individual liberties, thereby resurrecting the tyranny the revolution had overthrown. It was these fears that forestalled the establishment of a U.S. central bank until the end of the eighteenth century, and likewise sealed the demise of two U.S. central banks during the nineteenth century. And it was these fears that shaped the unique U.S. central banking system that was devised in the twentieth century.

. . . Checks and balances

Just as the concept of a central bank posed the same paradox the American people had encountered in creating institutions to govern them—that the power to promote the public good could also be used to contravene it—the same device, a system of checks and balances, was employed to resolve the paradox. These checks, or safeguards against the abusive use of central bank power, provide the Fed with its own paradoxical but uniquely American features.

On the one hand, the perceived need to place checks on the power and influence of the central bank itself dictated the Fed's uniquely decentralized design. Reserve Bank autonomy and the distribution of authority for monetary policy implementation between distinct components of the Fed parallel the distribution of counterbalancing powers between the various branches of the federal

government. And comparable to constitutional provisions which insured that the federal government's power would be less than absolute—preserving powers to the various states—voluntary membership restricted the central bank's control over the commercial banking system—preserving the dual banking system or the authority of state governments to charter and regulate banks.

On the other hand, various features of the Fed's structure have to be regarded as designed to limit the ability of those outside the institution from using the central bank to promote their own self-interest, i.e., to serve narrow economic or political purposes. Similar to the constitution of the federal government, the device employed to isolate the Fed from any single interest group was to subject it to a plurality of interests. Control over the Fed is diffused between the branches of the federal government and between the public and private sectors. The regional structure, the mechanisms for selection of officials, and the institutional separation of monetary and fiscal policy serve to insulate Fed policy from particular partisan or economic pressures; these features encourage its responsiveness to a diversity of influences—both geographic and sectoral.

With only very few exceptions the Fed's distinguishing characteristics are unchanged from 1914. Indeed, of the few modifications to the Fed's original structure, probably the most notable—the removal of two government officials from the Federal Reserve Board after 1935—further strengthened one of the Fed's unique features.

But the absence of major structural change is hardly sufficient evidence that Americans have discovered the ideal institutional framework for a central bank. Without doubt, Americans today are as firm as their predecessors in their distaste for concentrations of power. But the true test for the American people of the viability of any public institution must be whether the structure of the institution enhances its capacity to promote the public good as well as lessens its potential to harm it. If the Fed's structure is found at any future time to be inconsistent with the needs, goals and aspirations of the American people, it will likely be changed.

The Chicago Fed in review: 1976

In a sense, the major activities of a Reserve Bank today, like the structural characteristics of the Federal Reserve System, generally correspond to those outlined in the original Federal Reserve Act. Establishing a nationwide payments system by collecting checks deposited by banks, providing currency consistent with the needs of commerce by issuing Federal Reserve notes, providing liquidity to the banking system by discounting commercial paper, serving as the fiscal agent of the U.S. Government, supervising various commercial bank activities, and stabilizing financial markets through discount rate adjustments and the purchase and sale of securities—all these activities were discussed in the first annual report issued by the Chicago Fed for 1915.

Obviously, however, much has transpired during the past 60 years. The nation has experienced fantastic industrial and economic growth and has benefited from continuous technological progress. Financial institutions have become increasingly sophisticated, and regional markets have given way to truly national financial markets. And demands on public institutions to play a more active role in promoting the economic well-being of the American people have intensified. Each and all of these factors had and will continue to have a significant impact on Chicago Fed operations.

Payments mechanism operations

	Dollar amount		Number of items	
	1976	1975	1976	1975
Checks collected:				
Commercial bank checks	798.8 billion	714.4 billion	1.8 billion	1.6 billion
U.S. government checks*	42.2 billion	41.9 billion	104.2 million	120.0 million
Noncash items collected	1.4 billion	1.3 billion	.5 million**	1.1 million
Transfers of funds	6,007.7 billion	4,948.5 billion	3.4 million	2.8 million

*Includes postal money orders.
**Basis for counting items changed from 1975.

"On November 16, 1914, the date this bank opened for business, it installed a collection system..." The Chicago Fed's first annual report went on to say, "The development of the check-collecting function has proved the most difficult problem confronting the management of the bank."

A dramatic change has taken place in the magnitude and scope of Chicago Fed payments activities since 1915, reflecting the nation's economic growth and technological progress through the ensuing years. Perhaps unchanged, however, despite the fact that a "less-check" society no longer need be regarded in futuristic terms, is that check collection remains the Chicago Fed's most expensive function, and in a sense, as it was in 1915, its most difficult function. Since the five offices of the Chicago Fed—Chicago, Detroit, Des Moines, Indianapolis, and Milwaukee—consistently process more checks than in any other Federal Reserve District, increasing efficiency is a constant challenge. "Operations improvements" and productivity analyses have become the focal point of Chicago Fed check collection activities in order to ease and speed a continuously increasing work load. One result has been the implementation of new computer programs at all five offices during 1976.

But while the check remains a viable and much used payments instrument, certainly most discussed in the payments mechanism area today are the various developments which substitute electronic fund transfers for check payments. The Federal Reserve's systemwide communications network has for a number of years provided a facility for effecting paperless payments. The Chicago Fed currently processes more than $6 trillion in funds transfers annually through this system, a dollar total which greatly exceeds its check volume, and during 1976, the Detroit Branch for the first time passed the $1 trillion mark in funds transferred. Current efforts to expand and improve this system are aimed primarily at linking additional member banks "on-line" or computer-to-computer with the network. During 1976 six additional banks served by the Chicago head office and seven banks in the Detroit Branch territory were linked to the network for a total of 27 district banks, and the Detroit Branch was linked directly to Chicago. As a result, the volume of paperless transfers that could be processed instantaneously was greatly increased.

Chicago Fed participation in other electronic payments projects was also notable during 1976. Automated clearing houses (ACHs), which exchange electronic-based payment information such as direct deposit payrolls, have been organized with Chicago Fed cooperation in all five office cities. All are operational except the ACH in Milwaukee, and its implementation is imminent.

Finally, and probably most significant in terms of the number of current check payments eliminated by electronic transfers in the Seventh District, have been developments in the area of federal government recurring payments programs. The five Chicago Fed offices, the Treasury Department, and the district's financial institutions cooperated to automate Seventh District Social Security direct deposits during 1976—removing over half a million payments each

Statement of condition

(In thousands of dollars)

	As of December 31	
	1976	1975
Assets		
Gold certificate account	$ 1,704,081	$ 1,767,736
Interdistrict settlement account	570,496	324,257
Special drawing rights certificate account	190,000	79,000
Federal Reserve notes of other banks	76,709	71,867
Other cash	36,278	29,167
Loans:		
Secured by U.S. Government securities	7,020	46,000
Other	—	—
Total loans	$ 7,020	$ 46,000
Federal agency obligations, bought outright	1,087,925	914,637
U.S. Government securities	14,935,629	[1] 3,062,300
Total loans and securities	$16,030,574	$14,022,937
Cash items in process of collection	1,182,956	1,460,522
Bank premises	15,715	15,651
Other assets	238,751	206,022
Total assets	$20,045,560	$17,977,159
Liabilities		
Federal Reserve notes	$13,972,631	$12,464,478
Deposits:		
Member bank reserves	3,713,914	3,744,954
U.S. Treasury—general account	824,742	493,323
Foreign	36,062	40,440
Other	222,489	58,306
Total deposits	$ 4,797,207	$ 4,337,023
Deferred availability cash items	837,098	739,575
Other liabilities	142,708	152,375
Total liabilities	$19,749,644	$17,693,451
Capital accounts		
Capital paid in	$ 147,958	$ 141,854
Surplus	147,958	141,854
Total liabilities and capital accounts	$20,045,560	$17,977,159

The financial tements of private enterprises—balance s ets and statements of income—are statistical dicators of current and future capacity to g erate earnings. They provide a basis for eva ating performance. By contrast, Federal Rese Banks do not operate under an earnings obje ve although substantial earnings are incident to the functions performed. Changes in tl r major asset, liability and income items refl developments in the economy and actions dertaken in support of System monetary obj ives. Income consists mainly of interest on s bank's share of the System's portfolio of Tr sury securities. Most of this is returned to the easury after expenses and statutory dividenc o member banks are paid.

Through purchase securities and loans to member banks, the Re rve Banks increase the base for expansion in rency and deposits in accord with the econc y's growth needs. Additions to member ba reserve deposits that result from this proces re either withdrawn as currency or used to sup rt the public's deposits at commercial banks.

Last year almost a of the net increase in Reserve Bank credit wa bsorbed by the payout of currency (Federal R rve notes outstanding) in response to public c nands. Although commercial bank deposit ose slightly last year, member bank reserves clined, mainly because of lower reserve req ements and shifts of deposits between bank nd deposit classes with differing reserve requi nents.

System monetary p cy actions in 1976, aimed at providing reserv to the banking system sufficient to finance c tinued economic expansion, resulted in a billion increase in this bank's share of secur s held in the System Open Market Accoun he increase in interest earned on this larger p folio was the major factor accounting for the crease in 1976 earnings over 1975. It more than fset the effects of lower market interest rates, wer loans to member banks, reductions in t discount rate, and increased expenses. Re ting current earnings, less this bank's share o reign exchange transactions losses entailed currency stabilization operations, produced ecord payment to the Treasury.

Statement of earnings

(In thousands of dollars)

	Year ending December 31	
	1976	1975
Current earnings:		
Advances and discounts	$ 639	$ 1,588
U.S. Government securities	1,006,357	927,614
Foreign currencies	4,320	842
All other	251	255
Total current earnings	$1,011,567	$930,299
Current expenses:		
Operating expenses	$ 78,053	$ 71,844
Federal Reserve currency	6,009	4,112
Assessment for expenses of Board of Governors	6,365	5,168
Total	$ 90,427	$ 81,124
Less reimbursement for certain fiscal agency and other expenses	7,291	6,919
Current net expenses	$ 83,136	74,205
Current net earnings	$ 928,431	$856,094
Additions to current net earnings:		
Profit on sales of U.S. Government securities (net)	$ 5,111	$ 5,828
All other	214	317
Total additions	$ 5,325	$ 6,145
Deductions from current net earnings:		
Loss on foreign exchange transactions (net)	$ 3,836	$ 37,236
All other	61	33
Total deductions	$ 3,897	$ 37,269
Net deductions from (–) or additions to current net earnings	1,429	– 31,124
Net earnings before payments to U.S. Treasury	$ 929,860	$824,970
Dividends paid	$ 8,661	$ 8,453
Payments to U.S. Treasury (interest on Federal Reserve notes)	915,095	812,186
Transferred to surplus	$ 6,104	$ 4,331
Surplus account		
Surplus, January 1	$ 141,854	$137,523
Transferred to surplus—as above	6,104	4,331
Surplus, December 31	$ 147,958	$141,854

month from check-processing channels. Railroad and Civil Service retirement payments were also automated at year-end, and the automation of additional payments—such as veterans, revenue sharing, government salaries—can be anticipated.

Currency operations

	Dollar amount		Number of items	
	1976	1975	1976	1975
Currency received and counted	6.8 billion	6.5 billion	890.8 million	874.9 million
Unfit currency withdrawn.....	1.2 billion	1.2 billion	271.7 million	278.7 million
Coin received and counted	229.5 million	230.0 million	1.8 billion	1.7 billion
Food stamps received and processed.	938.5 million	870.3 million	244.7 million	282.7 million

About $4.4 million in Federal Reserve notes, the new currency created by the Federal Reserve Act, had been issued by the Chicago Fed at the end of 1915. Today, the Chicago Fed's balance sheet indicates that almost $14 billion of its notes are outstanding, reflecting current needs for currency to accommodate total spending in today's economy. But the significance of the Fed's currency activities is not the growth in the magnitude of these figures. Its real significance is how easily currency and coin flows to and from the Reserve Banks—into and out of the hands of the public—as the needs of commerce dictate.The nation today has the truly "elastic" currency that the Federal Reserve Act sought.

The Fed of Chicago satisfies the currency needs in its district by supplying currency and coin in whatever volumes and denominations its member banks request—which in turn correspond to the demands of bank customers—and charging member banks' reserve accounts. Conversely, when the public's stock of currency or coin held exceeds its needs, the excess flows back into commercial banks and ultimately to the Reserve Bank, where it is stored for reissue or withdrawn if unfit for further circulation. Currency operations at the Fed today also include the receipt—and destruction—of food stamps.

On April 13, 1976—Jefferson's birthday—the $2 bill was reintroduced by the Chicago Fed and other Reserve Banks. Substantial savings in Treasury printing costs and Federal Reserve handling costs could result from broad acceptance of the bill, i.e., where twos replaced ones. But despite promotional efforts, actual circulation of the $2 bill has not approached what had been desired. By year-end the Chicago Fed head office had issued about $61 million in $2 bills.

"Discount window" operations

	Dollar amount		Number of banks accommodated	
	1976	1975	1976	1975
Loans to member banks	2.6 billion	5.0 billion	114	166

When the Chicago Fed opened, its discount operation—providing short-term liquidity to member banks—was regarded as its paramount tool for influencing general money and credit conditions. Given the development of national money markets, which serve to efficiently channel funds to regions where they are most needed, other

Federal Reserve activities—especially open market operations—have become more effective devices for influencing the flow of money and credit in the national economy.

Nonetheless, the availability and extension of credit through the Reserve Bank "discount window" still serve an important economic stabilization function, and through time Fed credit programs have been modified and expanded. Provisions for longer-term emergency credit were added in the 1930s. More recently, in 1973, the seasonal borrowing program was implemented to aid banks, and thereby the communities they serve, located in areas where economic activity tends to follow pronounced seasonal patterns. Such banks—typically smaller institutions in rural areas—lack ready access to national credit markets. The original requirements for qualifying for seasonal credit, however, effectively precluded participation by many of the banks meant to be served by the program. A study by the Chicago Fed of 143 "seasonal" district banks found that certain restrictions excluded all but nine from qualifying for seasonal credit. As a result, seasonal borrowing program requirements were significantly liberalized during 1976.

"Bank service" operations

	Dollar amount		Number of items	
	1976	1975	1976	1975
Safekeeping of securities				
Definitive securities	7.7 billion	7.2 billion	1.6 million	1.6 million
Book entry securities	31.6 billion	21.3 billion	—	—
Purchases and sales of securities for member banks	1.1 billion	852.7 million	11.6 thous.	12.7 thous.

The payments, currency and lending activities of the Chicago Fed emanate from specific provisions of the Federal Reserve Act. Through time, the Fed has taken the opportunity to expand the range of its activities which interface with member bank operations for the purpose of enhancing commercial bank operating efficiency and/or System membership. Generally, these activities utilize Fed facilities and expertise developed in conjunction with statutory responsibilities or serve to encourage more efficient utilization of its facilities.

Examples of services provided by the Chicago Fed in this regard are: the purchase, sale and safekeeping of securities for member banks; the functional cost analysis and bank visitation programs; and various seminars and meetings with banks where Fed operations are discussed. During 1976 a new publication, *the FED WIRE*, was introduced to improve communication with district banks.

Supervision and regulation

Perhaps no single area of Federal Reserve operations has expanded so dramatically as its supervision and regulation responsibilities. Americans have increasingly demanded that the public sector take a more active role in assuring that the private sector's performance be consistent with the public interest, and the Federal Reserve has been significantly affected by this trend.

From its original activities, such as examining bank operations for safety and soundness and passing on applications for trust powers and membership, the Fed is today involved in the regulation of almost every phase of commercial bank operations: from mergers, branches, holding companies, and

bank operations abroad to the imposition of deposit interest rate ceilings, reserve requirements, and margin requirements for securities purchases. Particularly significant has been the recent development of Fed regulatory responsibilities in the area of consumer credit, where Congress has generally charged the System with formulating regulations applicable to all credit vendors, not solely commercial banks: Truth-in-Lending since 1969, Equal Credit Opportunity in 1975, and Home Mortgage Disclosure during 1976. And these newer regulations are themselves expanding as a result of subsequent Congressional legislation, e.g., the addition of Fair Credit Billing (in 1975) and consumer leasing (to take effect in 1977) to Truth-in-Lending, and the expansion of Equal Credit to prohibit racial, religious and other types of discrimination in addition to original provisions covering sex and marital status.

During 1976 the Federal Reserve's Board of Governors adopted a new regulation, AA—"Unfair or Deceptive Acts or Practices by Banks"—specifying formal procedures for handling consumer complaints. Complaints concerning district financial institutions are handled by the Chicago Fed's Consumer Affairs Division, established in 1975. The unit implemented in May of 1976 a pilot program of separate examinations of state member banks, focusing exclusively on regulation compliance. The unique Chicago Fed program, which is aimed at educating banks in new regulatory requirements as well as checking for institutional comformity, has drawn the interest of other federal bank regulators.

Fiscal agency operations

	Dollar amount		Number of items	
	1976	1975	1976	1975
Marketable government securities issued, serviced, redeemed:*				
Definitive securities	19.7 billion	43.9 billion	701.2 thous.	1.3 million
Book entry securities	589.0 billion	379.3 billion	221.4 thous.	204.8 thous.
U.S. savings bonds issued, serviced, redeemed	3.6 billion	3.6 billion	55.6 million	53.0 million
Fed tax receipts processed	41.4 billion	35.7 billion	4.4 million	6.6 million

*Includes transfers of securities.

The Federal Reserve Act provided that the Federal Reserve Banks could be appointed as the depositories and fiscal agents of the U.S. Government at the discretion of the Secretary of the Treasury. The assignment of these functions was announced on November 23, 1915. Since that time Chicago Fed fiscal agent operations have grown continuously, reflecting the constant growth in the financial needs and requirements of its "customer."

During 1976 a number of developments significantly affected the Chicago Fed's fiscal agency operations. The Federal Reserve-Treasury Department cooperative effort to encourage conversion of Treasury debt securities to "book-entry" form took a major step forward during the year. In August the Treasury announced plans to phase out the issuance of all definitive Treasury bills.(Efforts since 1968 had already resulted in the substitution of computerized accounting entries for paper or definitive certificates for over 80 percent of marketable public debt). Informational materials on book-entry were made available in the district by the Chicago Fed, and during December all 52-week bills were for practical purposes issued in book-entry form only. Issues of definitive securities for 26-week and 13-week bills are to be

eliminated in June and September 1977, respectively, and the program will undoubtedly be expanded to other marketable Treasury securities in the future.

The Chicago Fed, in cooperation with the Internal Revenue Service and Seventh District banks, also implemented a major change in its procedures for processing federal tax deposits during 1976. Early in the third quarter district banks serving as fed tax depositories began sending those deposits directly to IRS service centers rather than to the Chicago Fed for intermediate processing. Because of the change, tax payments are credited to taxpayer accounts far more expeditiously, and the number of unwarranted late notices should be drastically reduced.

Finally, during 1976 steps were taken to improve the public's understanding of Treasury securities. The Chicago Fed head office implemented a new 24-hour telephone service providing information on current Treasury offerings and produced a new general information fact sheet.

Monetary policy

When the Federal Reserve System was established, the discount function was regarded as its primary tool for influencing the flow of money and credit in the economy. The Act authorized the 12 regional Reserve Banks (subject to approval by the Federal Reserve Board) to change their individual discount rates. Largely to complement and support the discount function, the banks were also authorized to engage in open market operations—i.e., to purchase and sell securities for their own accounts. Later, Congress empowered the Federal Reserve Board to change reserve requirements within specified limits.

Because open market operations can be adapted continuously to changing economic and financial conditions, they have become the principal tool of monetary policy. And with financial markets now national in scope, such operations have had to be centralized: Reserve Banks no longer buy and sell securities independently. Instead, Reserve Bank presidents serve jointly with the Board of Governors on the Federal Open Market Committee (FOMC), which formulates policies and guidelines for transactions in the System Open Market Account.

Since 1975 annual monetary growth "target" ranges have been made public on a quarterly basis by the FOMC. The ranges set each quarter for the year ahead reflect the FOMC's judgment of the rate of monetary expansion consistent with the desired performance of the economy, taking account of factors affecting money demand. At the end of 1975 the range projected for growth of the basic money supply (currency and demand deposits) for the year ahead was 5-7½ percent. During the first quarter of 1976 the lower endpoint was reduced to 4½ percent and during the second and fourth quarters the upper endpoint was reduced to 7 and 6½ percent, respectively. The upper ends of growth ranges specified for broader measures of the money supply were also lower at the close of the year than at the start, consistent with the FOMC's goal of allowing for sufficient monetary expansion to finance continued economic growth while resisting inflationary pressures.

The System's other monetary policy tools were also employed in the direction of easier credit during 1976. Two "discount rate" reductions by the Chicago Fed's board of directors were approved by the Federal Reserve Board. Effective January 19 the (basic) "discount rate" was lowered from 6 to 5½ percent, and effective November 22, to 5¼ percent. (Reacting to the same needs, directors of other Reserve Banks instituted similar changes at roughly the same times.) In addition, actions by the Board of Governors reduced reserve requirements twice during 1976—on longer-term time deposits in January, and on demand deposits in December.

Directors *as of December 31, 1976*

Board of Directors, Federal Reserve Bank of Chicago, from left to right: (seated) Messrs. Strotz, Clark, Schoenhofen; (standing) Messrs. Farver, Hackett, Spies, Mayer, DeLay, Abboud.

PETER B. CLARK, Chairman
Chairman of the Board and President
Evening News Association
Detroit, Michigan

ROBERT H. STROTZ, Deputy Chairman
President
Northwestern University
Evanston, Illinois

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