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Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO • SEPTEMBER 1977

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CHECK TRUNCATION MOVES AHEAD

Less than six months from now, the Federal Reserve Bank of San Francisco will begin "truncating" Treasury checks, in another move designed to speed processing and cut handling and paper-work costs through the use of computers.

Truncating means that the San Francisco Fed—along with all the other Reserve Banks across the nation—will not have to return government checks to the Treasury. Currently some 700 million Treasury checks are processed annually by Reserve Banks and then shipped back to Washington, D.C. The new system will eliminate this massive and expensive trundling of tons of paper—some 2900 miles in the case of San Francisco—and improve the efficiency of the payments mechanism.

At the San Francisco Fed the switchover is scheduled for next February. At that time, the bank will begin generating magnetic tapes and microfilm copies of the checks. The tapes and microfilm will be forwarded to the Treasury Department's disbursing office. The checks themselves will be retained for about seven years in storage areas convenient to each of the bank's offices.

Pilot tests for the system have been underway for over a year and will continue through 1977. When truncation goes into effect, the Treasury will introduce a new type of paper check. The check will have all the necessary data encoded on it. As the checks are processed by computer-driven

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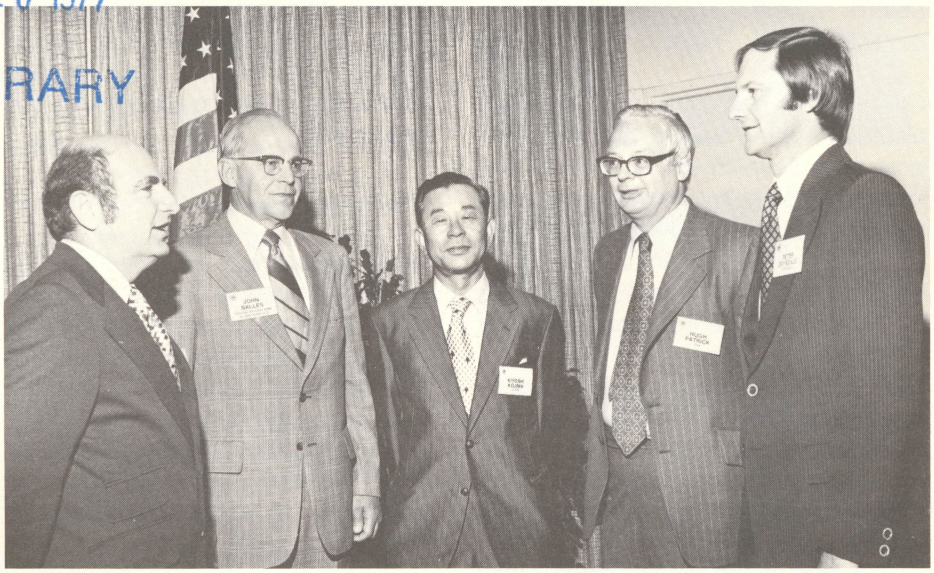

KICKING OFF PAFTAD—Shown with President John J. Balles of the San Francisco Fed (second from left) are several members of the steering committee for this year's Pacific Trade and Development Conference. They include (from left to right) Lawrence Krause, The Brookings Institution; Kiyoshi Kojima, Hitotsubashi University, Tokyo; Hugh Patrick, Economic Growth Center at Yale University; and Peter Drysdale, Australian National University, Canberra.

FED BANK HOSTS PACIFIC CONFERENCE

Over 30 policy-oriented economists and government officials from 15 countries attended the Ninth Pacific Trade and Development Conference at the Federal Reserve Bank of San Francisco last month. The week-long conference was organized by a committee which included Dr. Lawrence Krause (Brookings Institution), Prof. Hugh Patrick (Yale University) and Dr. Michael Keran (Federal Reserve Bank of San Francisco).

The theme of this year's meeting was the Pacific area's mineral resources and their impact on global economics and politics. The delegates represented both resource-rich and resource-poor Pacific Basin countries, as well as a balance of both developed and developing nations.

"The success of this series of meetings is reflected in its durability through the years," the Reserve Bank's President John J. Balles told the delegates in his welcoming comments. "This shows that the conferences have been addressing important issues and that the peoples and governments of Pacific Basin countries are interested in the results of your deliberations.

"In addressing a major economic issue—natural resources in an age of apparent scarcity—this conference deals with a number of unresolved issues which have generated conflict between nations and between private and public sectors. By analyzing the

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BALLES ANALYZES INFLATION "TAX"

Americans are continuing to suffer from the "silent yet severe tax" of inflation, President John J. Balles told a Town Hall audience in Los Angeles.

"Many people claim we should get used to a 'moderate' rise in prices of around five percent a year," Balles stated. "What would happen in our children's generation if we became used to an inflation rate of five percent?"

Citing just one example, he noted that an auto costing $4,600 today would cost over $40,000 in the year 2020. While admitting that wages would rise also, he said that under the progressive income-tax system the Federal tax bite for the worker now earning $3 an hour would rise from roughly zero to 30 percent of income. This would cut deeply into real income through the mechanism of the regressive tax of inflation.

Balles also pointed out that inflation still stands at an unacceptable level. He said that consumer prices had increased at a 9-percent annual rate in the first half of 1977—almost twice as fast as in the preceding half-year period.

The Fed President criticized the argument that the nation has to accept a certain amount of inflation to reduce the unemployment rate to respectable levels. Referring to recent work done by his research staff, he said that the typical response to a high rate of inflation is more rather than less unemployment. This is because rapid inflation reduces consumer confidence, forces households and businesses to save more and spend less, and thereby reduces the level of business activity.

"As a policy matter," he added, "we are not faced with a choice between competing alternatives, but rather with a straightforward imperative to fight inflation if we want to conquer unemployment."

The Fed official said that the severe inflation of the mid-1970s can be traced primarily to government policies first adopted a decade before. He noted that an upsurge in Federal government spending had created a cumulative deficit amounting to $337 billion over the past 15 years. This series of budget deficits consistently pulled monetary policy off target by supporting an excessive growth of money and credit.

Curing the problem means bringing the Federal budget into reasonable balance, while gradually slowing the growth of the money supply. He also said that a firm fiscal and monetary stance would help bring down the price of money—interest rates. He added that this point was widely misunderstood in the controversy over rising money-market rates this spring.

"Too few people clearly understand the long-term effect of price expectations on interest rates, and the way such expectations can offset other market influences. If lenders expect more inflation, they'll demand a premium to protect themselves against an expected loss in the purchasing power of their money. And borrowers will be willing to pay that premium because they expect to repay their loans with dollars worth less than the ones originally borrowed."

Balles said our recent experience has shown the crucial importance of inflation expectations in determining the direction of interest rates.

"Consequently," he concluded, "we should put the horse before the cart and work to curb inflation if we want to keep interest rates in check."

NEW RETIREMENT ACCOUNT DATA

Starting next month, the Federal Reserve Board of Governors will add a line to its monthly survey of time-and-savings deposits as a means of gaining more specific information on certain types of retirement accounts. The Board will collect information on the amount outstanding and most common interest rate paid on individual retirement accounts and Keogh deposits with original maturities of three years or more. Accounts with shorter original maturities will continue to be included with savings and short-term deposits.

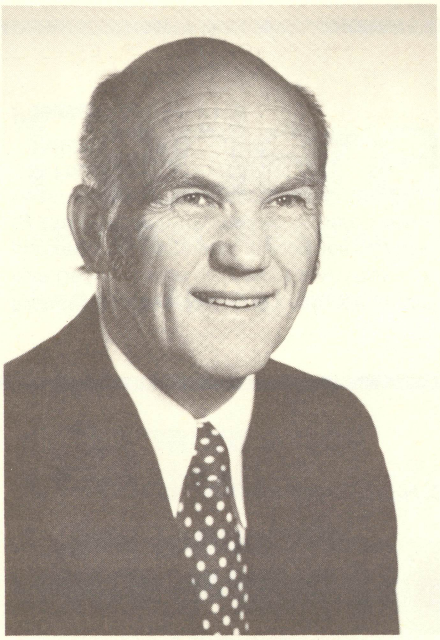
FED ANNOUNCES RULES FOR CASH DISCOUNTS

The Federal Reserve Board of Governors last month amended its Truth in Lending Regulation (Reg Z) by adopting provisions permitting discounts for customers that use cash instead of a credit card. The amendments, which became effective immediately, give merchants the option of offering discounts of up to five percent of the credit-card price.

Cash discounts were specifically authorized by the Fair Credit Billing Act in 1975. However, some critics argued that the Act might be interpreted to permit merchants to add surcharges for credit transactions instead of making discounts for cash transactions. Last year, Congress enacted new legislation to make a clear distinction between surcharges and discounts. The new Fed amendments incorporate these clarifications into Reg Z by detailing rules merchants must follow in applying the discount.

The amendments outline three specific examples of pricing systems merchants might employ to carry out the discount policy. For example, a merchant could post or tag goods with a single price. Under this discount pricing system, the single price would be the cost for a credit-card customer, while a discount could be deducted from this price for cash customers. A merchant could also use a "two tag" system with one price for credit cards and another for cash. Under a third alternative, the merchant could simply offer a five-percent discount off the prices charged to credit-card customers.

The Board also included a provision on advertising disclosure. If the lower cash price were advertised, merchants would have to state clearly that the price was not available to credit-card customers.



O. L. Christensen

FACILITIES PLANNING DIRECTOR NAMED

Oren L. Christensen last month accepted the post of Director of Facilities Planning for the Federal Reserve Bank of San Francisco. In this capacity he is responsible for the bank's planning, design and construction of new facilities—primarily the development of plans for a new San Francisco Headquarters.

Before joining the San Francisco Fed, Christensen was Assistant to the Vice President of Finance and Administration at Stanford Research Institute International in Menlo Park, California. Previously, he headed the Ground Station Planning Group of the Air Force Satellite Tracking Station Network as an employee of Lockheed Missiles and Space Company.

Christensen obtained extensive experience in civil and structural engineering after attending Fresno State College and the University of Santa Clara. He recently completed courses in facilities planning at the Graduate School of Design at Harvard University. He holds State of California licenses in both Civil and Structural Engineering. Christensen is a member of a number of honorary societies, including Beta Gamma Sigma, Chi Epsilon, Phi Beta Kappa, Sigma Xi, and Tau Beta Pi.

OVERCHARGE REFUND GUIDELINES DELAYED

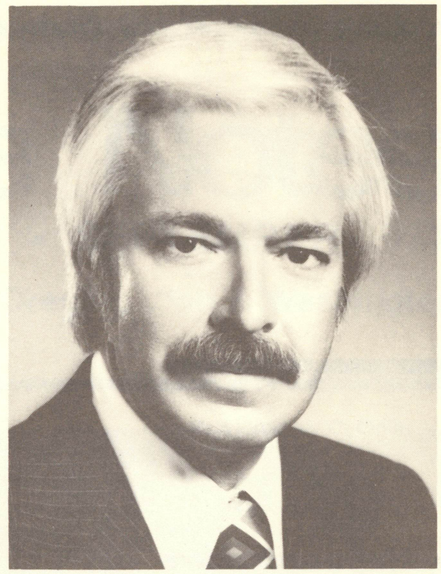
The Federal Reserve Board of Governors last month delayed issuance of guidelines that would spell out uniform procedures for handling loan-overcharge refunds, to give bankers and consumers time to make additional comments on the proposals.

All three Federal bank regulators—the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation—have pressed for guidelines that would enable them to treat loan-overcharge refunds uniformly. Over the last two years, the three agencies have been conducting consumer-oriented examinations to confirm compliance with Truth-in-Lending and other consumer-type legislation. These examinations have disclosed discrepancies that would require some banks to make refunds to their customers for overcharges.

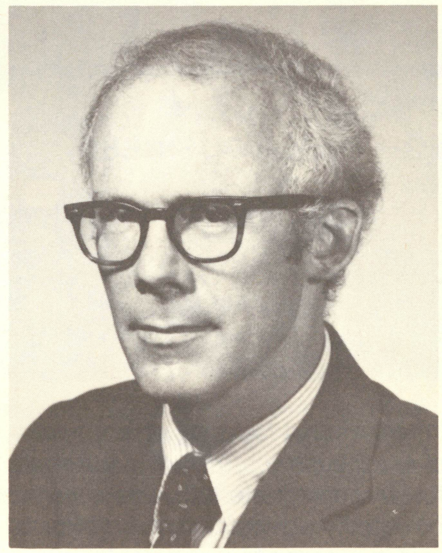
In a public discussion of the guidelines, the Board said it was imperative that both banks and customers be treated fairly. Some members stated it would be unfair to order banks to make full refunds for the entire eight-year-period that Truth-in-Lending had been on the books. Others contended that the statute of limitations would apply in some instances.

Chairman Arthur Burns commented that a banker who is "thoroughly honest" but whose "arithmetic is inadequate" should not necessarily have to repay eight years of overcharges to customers.

The Board also discussed whether refunds could be handled by allowing banks to offer shorter terms and lower interest on loans instead of cash payments. Federal Reserve staff members said these matters would be incorporated in a redrafted section of the guidelines that will be offered for additional comment to consumers and bankers.



R. C. Dietz



R. A. Johnston

BANK RELATIONS UNIT REORGANIZED

The Federal Reserve Bank of San Francisco last month organized a separate Bank Relations Department, as a means of improving services to member banks. The unit will be headed by Robert C. Dietz, Vice President, and by Robert A. Johnston, Assistant Vice President and Manager. The unit will report directly to Senior Vice President Kent O. Sims, instead of being lodged (as before) in the Bank's Research and Public Information Department. Working together with the management of the Bank's five branches, the new department will be responsible for developing programs designed to expand Federal Reserve membership and to solve broad types of service problems.

Federal Reserve Notes is produced by William Burke, Ronald Getz and Karen Rusk. The publication is distributed to commercial banks by the Research Information Center, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, California, 94120.
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FINANCIAL DATA FOR SMALL BUSINESS

Federal Reserve Chairman Arthur Burns last month proposed that a committee of economic and statistical experts develop a system to provide financial data that would aid small businesses.

"I believe that focusing on the needs of small business, including the need for an appropriate data base, would be both wise and progressive," Burns said in replying to a request for comments on a bill under consideration by the Senate Small Business Committee.

Part of the bill would require Federal regulatory agencies to disclose the volume of commercial-bank credit extended to commercial and industrial borrowers. However, the Chairman argued that this information would be of limited use, partly because it would not reveal the current volume or cost of bank lending to small businesses.

On the other hand, the Board announced support of provisions to establish a council to evaluate the impact of government programs on small business. The Board also endorsed legislation requiring the President to make an annual report to Congress, in which he would suggest programs and policies designed to meet the needs of small business.

PACIFIC CONFERENCE

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issues, proposing solutions, and publishing the results of your deliberations, you will be able to help policymakers and the general public make better informed judgments about natural-resource problems."

Besides the Federal Reserve Bank, other supporters of the conference included the Asia Foundation, the Ford Foundation, Crown-Zellerbach Corporation, Exxon Corporation, Bank of America, Standard Oil of California, Bechtel Corporation, Utah International, Inc., Crocker National Bank, International Institute for Economic Research, and the Foundation for Research in Economics and Education. Several foreign agencies also provided support.

A summary of the proceedings will be published this fall as a supplement to the quarterly *Economic Review* of the Federal Reserve Bank of San Francisco. The full proceedings, including all of the conference papers and discussion notes, will be published at a later date.

At the close of the conference, the steering committee announced that at least two future meetings are planned. They are scheduled for Australia in March of 1979, and for South Korea in early 1980.

CHECK TRUNCATION

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reader-sorters, the data will automatically be recorded on magnetic tape and the check will be microfilmed. The tapes will then be processed by the Treasury, with computer reconcilement of accounts.

The Treasury has scheduled the start-up of the truncation program so that it coincides with the depletion of current stocks of card checks around the first of the year. At that time the familiar green cardboard checks will become a thing of the past.

Truncation is yet another in a series of improvements initiated by the Treasury Department and the Federal Reserve System to capitalize on the economies offered by computer technology. One of the most significant programs now in effect is the electronic transfer of government payments for such recurring transactions as social security, supplemental-security income, civil-service retirement, railroad retirement and revenue-sharing checks. Every month about $3½ billion is disbursed electronically throughout the nation. The new system has entirely eliminated over five million paper checks each month.