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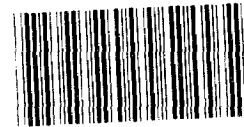
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BY THE COMPTROLLER GENERAL
**Report To The Honorable
Henry S. Reuss
House Of Representatives
OF THE UNITED STATES**

**Response To Questions
Bearing On The Feasibility
Of Closing The Federal Reserve Banks**

The need for Federal Reserve banks has been questioned due to the passage of the Monetary Control Act of 1980 which states that Federal Reserve banks must now charge their members for previously free services. In addition, the Congress has given some consideration to removing Federal Reserve bank presidents from the Federal Open Market Committee, which would remove their power to formulate monetary policy.



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The banks cost \$790 million to operate in 1980. They own land and equipment worth over \$853 million. However, savings which could be realized by closing the banks are uncertain. Cost, service, and policy issues must be resolved before the banks are closed to assure savings and realize the fair market value from sale of bank property. No alternative to the banks presently exists.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-201199

The Honorable Henry S. Reuss
House of Representatives

Dear Mr. Reuss:

This report discusses service, policy, and cost considerations bearing on the feasibility of closing the Federal Reserve banks which you asked us to review in your October 6, 1980, request as Chairman of the Committee on Banking, Finance, and Urban Affairs.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in cursive script that reads "Milton J. Fowler".

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE HONORABLE
HENRY S. REUSS
HOUSE OF REPRESENTATIVES

RESPONSE TO QUESTIONS
BEARING ON THE FEASIBILITY
OF CLOSING THE FEDERAL
RESERVE BANKS

D I G E S T

The Monetary Control Act of 1980 requires Federal Reserve banks to begin charging their national and State bank customers for services by September 1981. There is speculation that when Federal Reserve banks charge for services, private commercial banks will compete for and eventually win the Federal Reserve System's customers.

Considering these factors and an interest in holding down Government spending generally, the former Chairman of the House Committee on Banking, Finance, and Urban Affairs has questioned the need for the continued existence of the 12 Federal Reserve Districts. To aid the committee in its deliberations on this matter, GAO was asked to:

- Review the costs to operate the banks. (See ch. 2.)
- Determine the estimated market value of the banks' property and equipment. (See ch. 4.)
- Review the operating costs of one bank in detail, including administrative costs. (See ch. 3.)
- Present a discussion of the implications of closing the banks. (See ch. 5.)

The Federal Reserve System was established in 1913 to serve as the Nation's central bank. Central bank functions are carried out under the general guidance of a Board of Governors which oversees the activities of the 12 regional banks. (See ch. 1.)

Federal Reserve banks, the operating arms of the central banking system, perform numerous services for commercial banks

and the Government similar to services commercial banks provide for their business and individual customers.

OPERATING COSTS

Funds for operating the Federal Reserve banks are not appropriated by the Congress, but are provided out of Reserve bank earnings from open market trading and other sources. In 1980, Reserve bank earnings were estimated to be \$12.8 billion; operating costs about \$790 million. (See ch. 2.)

Expenses are broken down into four major categories, representing the Reserve banks' major functions:

- Monetary and economic policy.
- Fiscal agency functions.
- Services to financial institutions and the public.
- Bank supervision and regulation.

The operating costs of the Federal Reserve Bank of Boston are presented in detail to show how funds for operating costs are being spent. The Boston Bank's operating costs represent almost 7 percent of Reserve banks' operating expenses in 1979 and 1980. (See ch. 3.)

FEDERAL RESERVE BANK PROPERTY AND EQUIPMENT

Federal Reserve banks own many kinds of property--mostly real estate and equipment valued at slightly over \$853 million--that is used in carrying out normal bank operations.

The banks are undertaking extensive building programs. In the last 5 years, four new bank buildings were completed and numerous pieces of property acquired for future use. Building programs--new facilities or renovations--are now planned for seven additional banks. (See ch. 4.)

Items of operating machinery and equipment are also constantly being replaced and upgraded throughout the Federal Reserve System. These changes are necessary due to the requirements of the Monetary Control Act of 1980 as well as for System improvements in general. The act requires in part that Reserve bank services be priced and that depository institutions report financial information to the Federal Reserve System. (See ch. 4.)

IMPLICATIONS OF CLOSING FEDERAL RESERVE BANKS

Considerations of closing the Federal Reserve banks raise important cost, service, and policy questions. The banks have been in existence for nearly 70 years and have numerous responsibilities affecting domestic and foreign banking, the U.S. economy, and consumers in general. It is not readily apparent that any alternative exists that can replace them. Clearly no one alternative will answer all the service, policy, and cost considerations.

Because the Federal Reserve banks' services are necessary, were the banks to be eliminated, the need for similar services will still exist. In most cases, the various services or functions will have to be performed by someone else at a price. Whether or not any cost savings would result will require a careful study of cost-related factors, such as alternatives to providing similar services, the quality of the services to be provided, and the costs to the taxpayer.

Although some Reserve bank real property is located in choice urban sites in cities, disposal of such property may present unique problems. It is difficult, if not impossible, to predict how much money could be realized if the property is sold. In the past, banks have experienced gains as well as losses on real property disposals. (See chs. 4 and 5.)

AGENCY COMMENTS

The Federal Reserve was in basic agreement with the issues and conclusions of GAO on the factors to consider if the Reserve banks were closed, or functions abolished or transferred. The Federal Reserve's comments are reproduced in full in appendix VI.

C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Why the system was created	2
	The structure of the Federal Reserve System	3
	Federal Reserve bank functions	6
	Objectives, scope, and methodology	6
2	FEDERAL RESERVE BANK OPERATING COSTS	9
	Operating expenses are increasing	9
	Sources of revenues used for operating expenses	9
	The Federal Reserve System's cost reporting system	10
	Service lines represent bank operating costs	12
3	OPERATING EXPENSES OF THE BOSTON FEDERAL RESERVE DISTRICT	19
	Personnel expenses	20
	Materials and supplies expenses	21
	Equipment expenses	22
	Shipping expenses	22
	Travel expenses	23
	Communication expenses	24
	Building expenses	24
	Other expenses	25
4	FEDERAL RESERVE BANK PROPERTY AND EQUIPMENT	27
	Federal Reserve bank property by category	27
	Land	28
	Buildings	29
	Building machinery and equipment	30
	Operating machinery and equipment	31
	Artwork	31

		<u>Page</u>
CHAPTER		
5	SEVERAL INTERRELATED FACTORS NEED TO BE CONSIDERED BEFORE CLOSING THE FEDERAL RESERVE BANKS	33
	Savings and cost factors	33
	Policy factors	39
	Monetary and Economic Policy Service Line	40
	U.S. Treasury and Government Agencies Service Line	41
	Financial Institutions and the Public Service Line	43
	Supervision and Regulation Service Line	45
	Conclusions	47
	Agency comments	47

APPENDIX

I	Letter dated October 6, 1980, from Representative Henry S. Reuss	48
II	Federal Reserve bank operating expenses by service line--calendar year 1979	50
III	Federal Reserve bank operating expenses by service line--calendar year 1980	51
IV	Operating expenses of the Boston Federal Reserve Bank District--calendar years 1979 and 1980	52
V	Federal Reserve bank property by district	53
VI	Letter dated March 18, 1981, from Board of Governors of the Federal Reserve System	54

ABBREVIATIONS

FOMC	Federal Open Market Committee
GAO	General Accounting Office
FACS	Planning and Control System
RCPC	Regional Check Processing Center

CHAPTER 1

INTRODUCTION

The Federal Reserve System was created nearly 70 years ago to serve as the Nation's central bank, control the Nation's money supply, and improve the regulation of the Nation's commercial banks. It was established as a regional system: 12 Federal Reserve banks under the general guidance of a Board of Governors located in Washington, D.C. It cost about \$693 million to operate the Federal Reserve banks in 1979 and \$790 million in 1980--costs which some believe may no longer be necessary.

This belief has caused the following actions to be taken. In the 96th Congress, legislation (H.R. 7001) was introduced to remove the presidents of the Federal Reserve banks from participating in the Federal Open Market Committee, the principal formulator of monetary policy. The Monetary Control Act of 1980 requires the Federal Reserve System to begin charging, by September 1981, for services that it has been giving to its member banks (all national banks and about 1,000 State-chartered banks) for free. There has been speculation that the pricing of Federal Reserve services will result in private industry providing similar services and eventually competing away the System's customers.

Given (1) the attempt to remove the Federal Reserve bank presidents from the Federal Open Market Committee, (2) the thought that the Federal Reserve banks may no longer be needed to provide services to commercial banks, and (3) the desire to hold down Government spending generally, the former Chairman of the House Committee on Banking, Finance, and Urban Affairs has questioned the need for the continued existence of the 12 Federal Reserve banks. Thus the Chairman asked us to

- determine the estimated market value of all Federal Reserve bank property and real estate;
- determine all Federal Reserve bank operating expenses and categorize them by function;
- analyze, to the extent feasible, all operating expenses of one Federal Reserve bank; and
- describe the significant factors to be considered in any attempt to abolish or transfer Federal Reserve bank functions.

The 1979 and 1980 operating costs of the 12 Federal Reserve banks are described in chapter 2. That chapter also describes the services which generated those costs. The analysis of the 1979 and 1980 operating costs of the Federal Reserve Bank of Boston is presented in chapter 3. Chapter 4 discusses the property holdings of the Federal Reserve banks. The potential ramifications of a shutdown of the Federal Reserve banks are explored in chapter 5.

WHY THE SYSTEM WAS CREATED

The Federal Reserve System was a reaction to downturns in the Nation's economy during the early 1900s. The period was marked by many bank failures. The System was created to prevent such downturns through regulation of the money supply and effective supervision of U.S. banks.

The Federal Reserve System was established on December 23, 1913, when the Federal Reserve Act was signed into law. In broad terms the System had three purposes:

- (1) Regulating the Nation's money supply.
- (2) Serving as the Government's and the Nation's central bank.
- (3) Supervising the Nation's commercial banks.

The Federal Reserve System regulates the Nation's money supply by affecting (increasing or decreasing) the availability of reserves to support bank deposits. This is done by the purchase or sale of securities on the open market or by varying reserve requirements. The Federal Reserve also influences bank credit by controlling access to and interest rates for its own lending.

The System provides services to commercial banks, services which help the banking system function more smoothly. These central banking services include processing and clearing checks, furnishing new and destroying old currency, transferring funds electronically, maintaining reserve accounts, and lending funds to member banks.

The System has regulatory authority over national banks and those State-chartered banks which have joined the System. This regulatory authority is directed toward (1) preserving the financial soundness of the financial system and (2) insuring financial institutions' implementation of certain national policy objectives, such as equal credit opportunity and truth-in-lending.

THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM

The 1913 act established the Board of Governors and 12 regional banks. Over the years, the System has grown to include such committees as the Federal Open Market Committee and the Federal Advisory Committee as well as 25 branch banks and other facilities. National banks are automatically made members of the Federal Reserve System, and State-chartered banks are allowed to join upon approval of the Board of Governors.

Although membership has subjected banks to the System's reserve requirements, it has also given them access to several free services and to the Federal Reserve's lending operation (the "discount" window). The Monetary Control Act of 1980 subjects all depository institutions (banks, savings and loan associations, and credit unions) offering transaction accounts and nonpersonal time accounts to a reserve requirement and permits them to use the Federal Reserve's central bank services, but at a price. (See ch. 5.) Transaction accounts include demand deposits, and nonpersonal time accounts include corporate time deposits.

The Board of Governors

The apex of the System is the Board of Governors in Washington, D.C. As mandated by the 1913 act, the Board's seven members are appointed by the President of the United States. Appointments are for 14 years; terms are staggered, with one term expiring every 2 years.

The prime responsibility of Board members is the formulation and implementation of monetary policy. In meeting this responsibility, the Board establishes the percentage of deposits that member banks must maintain with the System or as vault cash (reserves). It issues rules concerning how and when the 12 Reserve banks may make "discount" loans to member banks. Changes in the interest rate for such loans, as proposed by Reserve bank directors, are subject to Board approval. The Board also establishes ceilings on the rates of interest that member banks may pay on time and savings deposits.

In addition to its money and credit responsibilities, the Board has broad supervisory and regulatory authority over the activities of its member banks, including their foreign activities. It also supervises the operations of the Federal Reserve banks. Under the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), the Board supervises and regulates bank holding companies.

The Board also has responsibility for implementing, by regulation, the major Federal consumer credit laws, such as the Truth in Lending Act and the Equal Credit Opportunity Act.

Federal Reserve banks

Federal Reserve banks are the middle of the pyramid formed by the Federal Reserve System and, as such, are the link between the Board of Governors and the approximately 5,600 commercial bank members. The banks are also the System's operating entities. In establishing this regional part of the System, the Congress had these purposes in mind:

- That all parts of the United States would have access to the Federal Reserve.
- That regional economic developments and needs would be represented.
- That there would be participation by private individuals, as reflected in the organization of the banks, while the Government would have final authority over national policy.

The Reserve banks as set up in 1913 were quasi-public institutions. The affairs of each bank are administered by a nine-person board of directors. Six of the directors are elected by member banks, representing member banks and the public; the remaining three, also representing the public, are appointed by the Board of Governors.

In addition to the Reserve banks, 25 branch banks have been established. The Federal Reserve also has established other facilities around the country, mainly for the purposes of check clearing.

Member banks

The commercial bank members are the base of the Federal Reserve System. All national banks are members, and State-chartered banks can become members if they meet the requirements established by the Board of Governors. The member banks own all of the stock of the Federal Reserve banks. However, ownership of that stock, which is a legal requirement of membership, does not carry with it all of the usual privileges of control and financial interest.

Membership in the System has been both a burden and a benefit to commercial banks. The burden has been the requirement that member banks maintain cash reserves (a percentage of their deposits) in non-interest-bearing accounts with their Federal Reserve bank--a requirement not imposed on nonmember banks or other depository institutions until the Monetary Control Act of 1980 became law. The benefit has been exclusive, direct, and no-cost access to the Federal Reserve System's central banking services and its loans. The Monetary Control Act of 1980 eliminated the exclusivity-of-access and free services benefits of membership.

Federal Open Market Committee

The Federal Open Market Committee (FOMC) came into existence because of a need to coordinate the buying and selling of Government securities by Federal Reserve banks. Prior to 1935, the banks could act independently in the buying and selling of Government securities to effect changes in the money supply. These uncoordinated open market operations caused disturbances in the Government securities market.

To offset future disturbances in open market operations, the Reserve bank presidents began to coordinate the conduct of open market operations through an informal version of the FOMC. With the passage of the Banking Act of 1933, the FOMC formally came into existence. However, each bank could refuse to participate in recommendations by the FOMC. It was not until the Banking Act of 1935 was passed that the FOMC was vested with the power to initiate and enforce open market operations for all 12 Reserve banks. The act also changed the makeup of the FOMC by replacing seven of the Federal Reserve bank presidents with the Governors of the System. With the exception of the President of the Federal Reserve Bank of New York, who is a permanent member, the bank presidents serve as members of the FOMC on a rotating basis.

Federal Advisory Council

Section 12 of the Federal Reserve Act established the Federal Advisory Council as a general advisor to the System. The Council consists of one member from each Federal Reserve bank who is selected by each bank's board of directors. The Council meets at least four times per year and exchanges ideas with the Board of Governors on economic and business matters and makes recommendations about System affairs.

FEDERAL RESERVE BANK FUNCTIONS

The Federal Reserve banks were established by the Congress as the operating arms of the Nation's central banking system. Many of the services performed by Reserve banks are similar to services performed by commercial banks for their business and individual customers.

The Federal Reserve Act of 1913, as amended, provides that Reserve banks perform functions for the Board and various central banking services for commercial banks and the U.S. Government. A typical Reserve bank holds the cash reserves of its member banks and makes loans to them. It also moves currency and coin into and out of circulation, thereby giving the country an "elastic currency." Millions of checks are collected and processed daily in Reserve bank facilities across the country. Reserve banks act as the Government's banker by providing checking accounts for the U.S. Treasury and performing other fiscal duties for Federal agencies. In addition, Reserve banks supervise and examine State member banks for safety and soundness and monitor how well they are complying with Federal community and consumer goals. With the use of their research staffs, Reserve banks take part in the primary responsibility of the Federal Reserve System: the setting of monetary policy. Reserve bank functions are discussed in more detail in chapters 2 and 5.

OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with the Chairman's request, our objectives were to

- identify all Federal Reserve bank operating costs and categorize them by function;
- identify all Federal Reserve bank real estate and other potentially disposable property and provide an estimate of its market value;
- identify and describe the costs to operate one Federal Reserve bank; and
- explain the savings, service, and policy factors involved in a shutdown of the Federal Reserve banks.

It was not our objective to determine the feasibility of shutting down the Federal Reserve banks, abolishing any specific service, or transferring any service responsibility to other Government agencies or to private firms.

Our work was performed at the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., and at the Federal Reserve Bank of Boston. We conducted work at the Board because it has general oversight for Federal Reserve activities, maintains overall expense records for the System, and examines the Federal Reserve banks. We selected the Federal Reserve Bank of Boston for more detailed cost analysis because its expenses were in the middle of the range of individual Federal Reserve banks' expenditures and because it had recently disposed of an old bank building, thus providing an example of the ramifications of such a transaction.

We analyzed the Board's overall Federal Reserve bank cost data contained in its Planning and Control System (see ch. 2) and discussed the various bank operations and services with Board officials. Because full-year actual costs for 1980 were not available, we have used actual costs for three-quarters of 1980 plus estimates for the fourth quarter to represent total 1980 costs.

We obtained a compilation of Federal Reserve bank property from each bank through the Board's Division of Federal Reserve Bank Operations.

The estimated values for property were derived from

- local tax assessments or estimates of market values for land and buildings,
- acquisition cost for artwork and construction in progress, and
- net book values for other items.

Given the deadlines established in the request, independent appraisals were not feasible.

At the Federal Reserve Bank of Boston, we reviewed accounting records and account descriptions to obtain examples of administrative costs. We discussed the expenses of and the services provided by the bank with bank officers and staff. We did not audit the expense records to determine their accuracy or the appropriateness of the expenditures.

We did not explore the impact of closing the Federal Reserve banks with others who might be affected by it, such as commercial banks, other Government agencies, or private industry suppliers of services.

The Federal Banking Agency Audit Act (Public Law 95-320) precludes our review of

"* * * deliberations, decisions, and actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations; * * *."

Therefore, we were unable to explore fully the contribution that Federal Reserve bank staffs make to monetary policy formulation.

CHAPTER 2

FEDERAL RESERVE BANK OPERATING COSTS

The operating costs of Federal Reserve banks have risen over the years because of increases in the volume of services they provide and inflation. Reserve bank earnings, which are used to defray costs of operations, have also increased. In 1977, the Reserve banks implemented a uniform system for monitoring and controlling operating expenses. Operating expenses are being monitored by major functional areas generally referred to as service lines, as well as by traditional object classes.

OPERATING EXPENSES ARE INCREASING

The expenses for the principal operations of the Federal Reserve banks have increased over the years. In calendar year 1978, net operating expenses were slightly over \$652,600,000 and about \$693,500,000 in 1979. Net operating expenses are estimated to be \$790,174,000 for 1980. Net operating expenses are total operating expenses less any reimbursables and recoveries, generally for services provided by Reserve banks to Government agencies and others under arrangements for recoveries of part or all of the cost to provide such services. In 1979, reimbursements and recoveries totalled \$68,800,000. For 1980 they are estimated to be \$75,697,000.

The 1980 bank operating expenses increased due to inflation, increased activities, labor market conditions, and legislative mandates. Also, upgrading and improving System services, facilities, and internal management systems and procedures are among the reasons given for increased operating costs in 1980.

SOURCES OF REVENUES USED FOR OPERATING EXPENSES

The Federal Reserve System's revenues are derived primarily from the interest that the Federal Reserve banks earn on their holdings of securities acquired through open market operations. Such earnings are allocated to three major areas. First, earnings are allocated to the payment of Reserve bank operating expenses and the assessments by the Board of Governors to defray its expenses. Although Board expenses are paid by the banks, they are not considered part of the expenses for the banks' principal operations. Board expenses were \$50,530,000 in 1979 and are estimated to be \$62 million in 1980. Reserve banks' earnings are next allocated to the statutory 6-percent dividend on Federal Reserve stock required to be purchased by member banks and any additions to the

surplus necessary to maintain each Reserve bank's surplus earnings equal to its paid-in capital stock.

The remainder of the earnings is then paid voluntarily into the U.S. Treasury in the form of a tax on Federal Reserve notes. The transfer to the Treasury is on a purely voluntary basis, and the amount turned back to the Treasury each year is treated within the Federal budget as a receipt, serving to offset Federal Government outlays. In 1979, the banks returned \$9.3 billion to the Treasury. In 1980, \$11.7 billion will be returned to the Treasury. The chart below shows how Reserve bank earnings have been used in the last 2 years.

	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u>
		(note a)
	---(millions)---	
Reserve banks net operating expenses	\$ 693	\$ 790
Net deductions from current earnings (note b)	151	115
Assessments for expenditures of		
Board of Governors	51	62
Dividends paid	67	70
Payments to U.S. Treasury	9,279	11,707
Transferred to surplus	<u>69</u>	<u>57</u>
 Total bank earnings	 <u>\$10,310</u>	 <u>\$12,801</u>

a/1980 operating expenses represent actual cost for the first three quarters and estimated expense for the fourth quarter.

b/This item includes losses on sales of U.S. Government securities and profits or losses on foreign exchange.

THE FEDERAL RESERVE SYSTEM'S COST REPORTING SYSTEM

Although each Federal Reserve bank is separately incorporated and operates independently of the others, all bank operating costs are accounted for uniformly. The Federal Reserve banks developed and, in 1977, implemented the Planning and Control System, an expense monitoring and reporting system, commonly referred to as PACS. Under PACS, operating expenses are grouped into several meaningful formats and categories for analysis and reporting. For example, operating

expenses may be categorized by object classifications and by major functional areas referred to as service lines. Since the service lines are both descriptive of the Reserve banks' main operations and include all related costs, the following section presents a discussion of operating costs by service lines.

Service lines represent the ongoing responsibilities of the Federal Reserve System expressed in terms of the broad categories of output generated by the banks. For example, Supervision and Regulation is a major function of the banks and is one of the four service lines. Service lines are further divided into subcategories of expenses. Services are basic programs used to fulfill ongoing responsibilities of a service line. Activities are the basic operations or processes within each service. For example, the "Commercial Bank Examinations Activity" is part of the broader "Supervision of District Financial Institutions Service." The latter is part of the "Supervision and Regulation Service Line." All System project costs and overhead are allocated to each service. Each activity is also assumed to include all related clerical and administrative operation costs. Therefore, the total of the four service lines represents the total cost of operating the banks and their branches and facilities. The chart on the following page shows the service lines and associated operating costs for the last 2 years.

<u>Service line</u>	<u>Calendar year</u>	
	<u>1979</u> <u>(note a)</u>	<u>1980</u> <u>(note b)</u>
	--(thousands)--	
Monetary and Economic Policy	\$ 38,244	\$ 53,550
Services to U.S. Treasury, Government Agencies	83,536	93,422
Financial Institutions and the Public	572,762	631,844
Supervision and Regulation	<u>67,753</u>	<u>87,055</u>
Total expenses	<u>\$762,295</u>	<u>\$865,871</u>
Reimbursements/recoveries	<u>(68,800)</u>	<u>(75,697)</u>
Net expenses	<u>\$693,495</u>	<u>\$790,174</u>

a/1979 figures are actual expenses.

b/1980 figures represent actual expenses for the first three quarters and estimated expenses for the fourth quarter.

SERVICE LINES REPRESENT BANK OPERATING COSTS

Monetary and Economic Policy Service Line

Monetary and economic policy functions consist of open market operations, Treasury issues, and foreign banking functions. All operating costs associated with monetary and economic policy determination, analysis, and reporting are summarized under the Monetary and Economic Policy Service Line. In calendar year 1980, total cost for this service line will be almost \$54 million, or about 40 percent higher than the 1979 level. Board officials stated that this increase was necessary for the Reserve banks to be able to meet the reporting requirements of the Monetary Control Act of 1980. Almost all of the increases were for the Economic Policy Determination Service.

Operating costs relating to this service line are shown below.

<u>Services</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
	--(thousands)--	
Economic Policy Determination	\$32,055	\$46,652
Open Market Trading	<u>6,189</u>	<u>6,898</u>
Total expenses	<u>\$38,244</u>	<u>\$53,550</u>
Reimbursements/recoveries	(<u>378</u>)	(<u>503</u>)
Net expenses	<u>\$37,866</u>	<u>\$53,047</u>

a/Actual operating expenses for the first three quarters and estimated expenses for the fourth quarter.

Almost one-third of the total cost relating to this service line is for operations at the Federal Reserve Bank of New York. All of the cost relating to the Open Market Trading Service is for operations at the New York Bank, except for \$28,000 spent in 1979. The New York Bank is unique in that it has primary responsibility for the System's open market functions and acts as the operating arm for the System in central banking relationships with foreign central banks, foreign governments, and international organizations.

Open market trading is the principal instrument used by the Federal Reserve to implement national monetary policy. It is also the primary source of Reserve bank earnings. The trading desk at the New York Bank buys and sells U.S. Government securities and other securities in the open market in a way that increases or decreases bank reserves. The desk gets its instructions from the System's key policymaking group, the FOMC, which meets every month in Washington.

The operating expenses for the Economic Policy Determination Service are for the gathering and analyzing of economic data. Each Federal Reserve bank has a research staff to gather and analyze a wide range of economic data and interpret conditions and developments in the economy. Statistics are gathered and analyzed by economists on every industry and every region of the country. This research assists the FOMC in the formulation and implementation of monetary policy, and it also contributes to informed decision-making by the Federal Reserve banks in bank supervisory matters and other areas. Just over \$32 million was spent for

this service's cost in 1979. The costs for 1980 are estimated to be almost \$47 million.

Services to U.S. Treasury and
Government Agencies Service Line

All of the operating costs related to providing services to the Treasury and Government agencies are grouped under the U.S. Treasury and Government Agencies Service Line.

In the chart that follows, the operating costs associated with providing services to Government agencies and the Treasury Department for fiscal agency functions are summarized by service.

<u>Services</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
	--(thousands)--	
Savings bonds	\$30,495	\$33,977
Other Treasury issues	20,819	24,417
Government agency issues	3,892	4,536
Other Treasury and Government agency services	6,950	7,853
Treasury and Government agency coupons	2,588	2,735
Food coupons	6,404	6,999
Government accounts	<u>12,388</u>	<u>12,905</u>
Total expenses	<u>\$83,536</u>	<u>\$93,422</u>
Reimbursements/recoveries	(<u>51,801</u>)	(<u>56,402</u>)
Net expenses	<u>\$31,735</u>	<u>\$37,020</u>

a/1980 figures represent actual expenses for the first three quarters and estimated expenses for the fourth quarter.

The Reserve banks maintain the Treasury's checking account and other Government accounts for employer withholdings of Federal taxes, social security payments, and corporate deposits of excise and business taxes.

In 1979, \$30.5 million was spent by the Reserve banks for savings bonds operations. These costs were incurred by the banks in their roles as issuing and paying agents for the Treasury Department. Although some commercial banks are also issuing and paying agents for savings bonds, only

Reserve banks handle such unique transactions as reissuing bonds, issuing the special retirement series bonds, and making name changes.

In addition to handling savings bonds operations, the reserve banks perform various services for other Treasury issues, including receiving applications from the public for the purchase of securities being sold by the U.S. Treasury, allotting securities among bidders, delivering securities, making wire-transfers of securities to other cities, making denominational exchanges of securities, paying interest coupons, and conducting transactions in the market for various Treasury accounts. Most of these activities are under the general supervision of the Treasury, which reimburses the Reserve banks for most of the costs incurred.

The reserve banks also perform fiscal agency services in connection with the financial activities of various Federal or Government-sponsored credit agencies. They are reimbursed by the Treasury or other Government agencies for much of the expense incurred. The Federal Reserve Bank of New York also performs some fiscal agency functions for foreign central banks and other foreign official and international accounts, such as handling and safekeeping their investments in Treasury and similar securities and holding part of their gold stock under earmark custody of their account.

Financial Institutions and the Public Service Line

The Federal Reserve banks provide many services to the banking community and the general public. The cost of providing these services represents about 80 percent of the reserve banks' operating expenses in 1979 and 1980 estimated expenses. The volume of services Reserve banks will continue to provide to banks and the public in the future may be affected when the Federal Reserve starts pricing these services as required by the Monetary Control Act of 1980. The reserve banks' operating budgets for these services may ultimately be affected. (See ch. 5.)

The chart on the following page shows the operating cost for this service line for 1979 and 1980. As indicated, the reserve banks' net operating costs for services to commercial banks and the public were about \$556.5 million and \$613.6 million for 1979 and 1980, respectively.

<u>Services</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
	--(thousands)--	
Currency	\$151,098	\$158,239
Coin	29,896	30,818
Electronic funds transfers	36,385	49,635
Commercial check	244,969	282,110
Other check	13,316	14,587
Securities	21,167	23,283
Loans to members and others	5,751	7,375
Reserve account	15,398	(b)
Non-Cash collection	8,298	11,493
Bank and public relations	25,991	29,410
Other	20,493	24,894
Total expenses	<u>\$572,762</u>	<u>\$631,844</u>
Reimbursements/recoveries	<u>(16,219)</u>	<u>(18,235)</u>
Net expenses	<u>\$556,543</u>	<u>\$613,609</u>

a/Actual expenses for the first three quarters and estimated expenses for the fourth quarter.

b/In 1980, reserve account service costs were allocated to activities in two different service lines.

The services Reserve banks provide to the banking industry and the public are important ones. As indicated by PACS data, the commercial check service is by far the largest service in terms of expense. For 1980, it is estimated that costs will be approximately \$282 million to provide the service of processing, sorting, and returning commercial checks.

Operating costs for the currency and coin services include the costs of separating currency into fit, unfit, and counterfeit categories. Fit currency is wrapped for recirculation, unfit is destroyed, and counterfeit is turned over to the Secret Service. Coins received from banks are weighed, counted, sorted, and wrapped. After being weighed again and bagged, they are ready for distribution to member banks. In 1979, the operating costs for the currency and coin services were \$151,098,000 and \$29,896,000, respectively. Only slight increases in costs were projected for these services in 1980.

Fast and efficient transfers of money over long distances by wire rather than check are possible using the electronic funds transfers system. All 12 Federal Reserve

banks and their branches are linked to each other in a communication system which includes a computer switching center in Culpeper, Virginia. This service cost the banks about \$50 million in 1980, an increase of \$14 million over the 1979 level.

Supervision and Regulation Service Line

One of the purposes of the original Federal Reserve Act was to establish more effective supervision of banking. In carrying out this purpose, the Federal Reserve System has been given important responsibilities for regulating the structure and operations of the U.S. banking system and related activities. In broad terms, these responsibilities include the supervision of banks and the administration of laws and regulations related to banking. The chart below summarizes Reserve bank operating costs associated with supervision and regulation responsibilities for 1979 and 1980. As shown, the 1980 net operating costs were estimated to be \$86,498,000 or about 28 percent more than the 1979 level.

<u>Services</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
	--(thousands)--	
Supervision of district financial institutions	\$45,003	\$53,188
Administration of laws and regulations related to banking	19,249	29,739
Banking and financial market structure studies	<u>3,501</u>	<u>4,128</u>
Total expenses	<u>\$67,753</u>	<u>\$87,055</u>
Reimbursements/recoveries	(<u>402</u>)	(<u>557</u>)
Net expenses	<u>\$67,351</u>	<u>\$86,498</u>

a/Actual expenses for the first three quarters and estimated expenses for the fourth quarter.

Most of this service line's operating costs are for the supervision of district financial institutions. Reserve banks conduct onsite examinations of State member banks and have authority to approve certain types of applications of State members--for example, to establish domestic branches. Bank personnel costs and travel expenses incurred in conducting

onsite bank examinations comprise the largest part of the operating cost for this service.

The Reserve banks also administer laws and regulations relating to banking. For example, the Federal Reserve is responsible for administering the Bank Holding Company Act (12 U.S.C. 1841, et seq.). In carrying out their responsibilities, Reserve banks supervise and regulate the activities of bank holding companies and their nonbank subsidiaries by monitoring their financial condition, making onsite inspections, determining compliance with Federal banking laws and regulations, and acting on applications to form bank holding companies or to establish or acquire additional bank or nonbank subsidiaries.

Reserve banks also act on applications for bank branches, bank mergers, and membership in the Federal Reserve System. In addition, Reserve banks have responsibilities regarding member banks' international operations.

The banks' role in consumer affairs activities is being enlarged. Reserve banks are currently involved in rule-making and compliance-type activities concerning many consumer laws and regulations, including the Truth in Lending Act and the Community Reinvestment Act. The Reserve banks also investigate complaints filed against State member banks in their districts and refer other complaints to the appropriate agencies. Federal Reserve officials anticipate that consumer affairs activities will expand, especially at the local community level.

CHAPTER 3

OPERATING EXPENSES OF THE

BOSTON FEDERAL RESERVE DISTRICT

We reviewed the operating costs of the Boston Federal Reserve District in detail to determine more specifically how bank earnings allocated to operating costs are actually being spent. We used cost data accumulated for the uniform cost monitoring and reporting system (PACS).

The Boston Federal Reserve District was selected because its expenses were in the middle of the range of individual Federal Reserve bank expenditures. In 1979, about \$46.3 million, or almost 7 percent of the Federal Reserve banks' net expenses, was used to operate the Boston District. The Boston District's expenses represent the costs of operating the Boston Bank (including a storage facility at Amherst, Massachusetts) and two Regional Check Processing Centers (RCPCs)--one at Lewiston, Maine, and another at Windsor Locks, Connecticut. This district's costs were expected to increase moderately in 1980. Estimates from Boston Bank officials showed 1980 operating costs to be \$51.5 million, or about 6.5 percent of the Federal Reserve banks' net expenses. The chart below summarizes operating costs of the Boston District by service line.

<u>Service line</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
	--(thousands)--	
Monetary and Economic Policy	\$ 2,357	\$ 3,740
Services to U.S. Treasury, Government Agencies	4,607	4,851
Financial Institutions and the Public	40,754	44,511
Supervision and Regulation	<u>4,672</u>	<u>5,332</u>
Total expenses	<u>\$52,390</u>	<u>\$58,434</u>
Reimbursements/recoveries	<u>(6,079)</u>	<u>(6,942)</u>
Net operating expenses	<u>\$46,311</u>	<u>\$51,492</u>

a/Actual expenses for the first three quarters and estimated expenses for the fourth quarter.

The PACS reports operating costs by object class for each service line and activity. Object classes, such as personnel, travel, and equipment are another way of summarizing Reserve bank operating costs. We reviewed the Boston Bank's detailed support for its expenses by object class. The chart below summarizes the operating costs of the Boston District by object class. These expenses are discussed in detail in the sections which follow.

<u>Object class</u>	<u>Calendar year</u>	
	<u>1979</u>	<u>1980</u> (note a)
Personnel	\$29,937,100	\$32,842,400
Materials and supplies	2,153,700	2,327,800
Equipment	2,971,700	3,476,600
Shipping	4,171,600	4,956,800
Travel	557,200	693,100
Communications	788,000	822,300
Building	6,586,000	8,035,400
Other	5,384,500	5,424,300
Contra expenses (note b)	<u>(160,700)</u>	<u>(145,000)</u>
Total expenses	<u>\$52,389,100</u>	<u>\$58,433,700</u>
Reimbursements/recoveries	<u>(6,078,600)</u>	<u>(6,942,000)</u>
Net operating expenses	<u>\$46,310,500</u>	<u>\$51,491,700</u>

a/Actual expenses through third quarter and estimated expenses for fourth quarter.

b/This item includes expenses for labor and materials temporarily capitalized and charged to activities when the products are consumed.

PERSONNEL EXPENSES

In 1979, the Boston Federal Reserve District employed 1,480 persons on the average: 1,336 in Boston; 20 in Lewiston, Maine; and 124 at Windsor Locks, Connecticut. This district employs 49 officers--1 president, 1 first vice president, 5 senior vice presidents, 17 vice presidents, and 25 assistant vice presidents. One assistant vice president heads both the Maine and Connecticut RCPCs. The personnel expenses include three major categories: (1) salaries and wages, (2) retirement and other benefits, and (3) other personnel expenses.

Salaries and wages include salaries paid to bank officers and employees, hourly wages, and overtime. In 1979, overtime was nearly \$1 million--mainly for operations at the Connecticut RCPC and the Boston Bank's check collection and money departments.

Retirement and other benefit expenses include payments made for current employees (\$6,118,900) and for retirees (\$747,900). About 77 percent of the 1979 retirement and other benefit expenses were for regular retirement system current service, social security, and hospital/medical insurance plans. Other expenses for current employees include \$226,500 in contributions to the Thrift Plan (a voluntary supplement to the retirement system). The bank also contributed \$5,650 for an annual payment to one employee who retired under a special agreement with the Boston Federal Reserve Bank prior to its implementing the current retirement system in 1970.

Other personnel expenses consist of extended leaves of absence, separation pay, meal allowances, and outside agency help. Extended leaves of absence comprised about 61 percent of the total other personnel expenses and were paid to employees absent due to extended illness or other approved absences (except vacations) for more than 30 consecutive calendar days. Separation pay is based on 2 weeks' salary for each year of service and totalled \$10,600 in 1979. In 1979, no payments were made to bank officers for separations or extended leaves of absence. Meal allowances, which totalled \$27,600 in 1979, are payments made to officers and employees for meals while working overtime. Outside agency help, which totalled \$50,577 in 1979, is temporary contractual hourly services for work normally done by bank employees.

MATERIALS AND SUPPLIES EXPENSES

In 1979, the bank spent \$2,153,700 for materials and supplies, as shown below:

- Routine office supplies, \$1,037,000.
- General office forms and supplies, \$222,800.
- Bank publications, \$244,800.
- Other, \$649,100.

General office forms and supplies are generally low-usage office supplies not stocked in central inventory, such as over-sized binders and special columnar pads. Examples of purchases charged to this account in 1979 are binders with gold tooling (\$42 each), attache cases (\$81 each), carryon luggage (\$120 each), and leather desk pads (\$125 each).

Publications include all material published by the Boston District, such as the bimonthly New England Economic Review, the bank's primary publication.

Other materials and supplies expenses include building materials and supplies; vehicle and office equipment supplies and parts; newspapers and books (\$71,927); technical professional publications for the data processing, audit, and personnel functions; and workclothes and uniforms (\$14,822) for security officers, maintenance personnel, electricians, plumbers, and Coin Department employees.

EQUIPMENT EXPENSES

In 1979, the bank spent \$2,971,700 for equipment expense, as shown below:

- Equipment rentals, \$1,745,000.
- Equipment depreciation, \$819,700.
- Equipment repair and maintenance, \$407,000.

Rental expenses relate to computers, data communications, and general office furniture and equipment. Repair and maintenance expenses include the cost of such work performed either under a monthly or annual contract or on an as-needed basis.

SHIPPING EXPENSES

In 1979, the bank spent \$4,171,600 for shipping expenses, as shown below:

- Postage, \$632,000.
- Armored carrier, \$2,019,800.
- Other shipping, \$1,519,800.

Postage expenses include the cost of all ordinary postage, registration fees, insurance on security and money shipments, surcharges, postcards, postage paid through the use of postage meter machines, and postage on direct-sent cash letters. This account also includes any reimbursements made to commercial banks for postal shipments made at their expense.

Armored carrier costs include all private contracts for armored car service and the reimbursements made to commercial banks for armored car shipments made at their expense. The bank has contracts with six companies to provide this service: Berkshire, Brinks, International, Purolator, Wells Fargo, and Massachusetts Transport.

Other shipping expenses include the cost of all public and private carrier contracts for courier service. Also included is the Boston District's pro rata share of the Inter-District Air Charter Service costs and all other express, freight, and cartage charges.

TRAVEL EXPENSES

Travel expenses include the cost of all travel by directors, members of the Federal Advisory Council, officers and employees, and individuals not employed by the bank (e.g., consultants) but authorized to travel on Reserve bank business. The expenses amounted to \$557,200 in 1979 and include

- lodging costs;
- subsistence;
- railroad, airplane, and taxicab fares;
- mileage allowances;
- rental of passenger vehicles for specific trips; and
- miscellaneous expenses such as telephone, laundry, valet, tools, and storage.

In 1979, over 98 percent of the travel expenses were for travel within the United States. Travel costs were incurred in performing bank examinations, attending meetings and conferences, and performing services for the American Institute of Banking.

Foreign travel expenses totalled about \$7,300 in 1979, and consisted of two trips--one to Europe by the first vice president and one to Japan by the vice president of international research--to study world money payment mechanisms.

COMMUNICATION EXPENSES

In 1979, communication expenses totalled \$788,000. About 84 percent of the communication expenses were for commercial telephone and telegraph services, including installation charges; switchboard rentals; instruments and call directors; listings in outside telephone directories; long-distance toll charges, unit message charges, FTS, and WATS lines; and message charges related to off-line data communications equipment.

The remaining communication expenses were for a pro-rata share of the costs of the Federal Communications System, an electronic funds transfer system which includes the Culpeper Communications Center, leased communications lines, circuit termination equipment, and low-speed terminals.

BUILDING EXPENSES

In 1979, the bank spent more than \$6.5 million or 13 percent of the bank's total operating expenses, on building expenses, as shown in appendix IV. These expenses were for normal costs incurred with the ownership and/or occupancy of buildings. Building expenses included the following:

- All insurance premiums paid in connection with the ownership and/or occupancy of buildings, including public liability insurance. The bank is self-insured for major losses and is covered by the System-Wide Loss Sharing Agreement.
- Real estate property taxes for bank-owned property.
- Depreciation expense on buildings, fixed machinery and equipment, furniture, furnishings, and fixtures.
- Utilities expenses, such as the cost of fuel and payments made to utility companies for water, electricity, steam, and gas.
- Rent expenses for space leased for the RCPCs (\$246,450); cost of relocation sites; safe deposit boxes; post office box rental; and space rented at cash agents banks. Also included are payments for utilities, repairs and alterations, and amortization of leasehold improvements.

--Building contractual services, such as contract cleaning, elevator maintenance, and other outside repairs and alterations.

OTHER EXPENSES

In 1979, more than 10 percent, or \$5,384,500, of the Boston District's operating expenses were described as "Other." These expenses include charges for: (1) Federal Reserve currency, (2) fees, and (3) other miscellaneous expenses. Examples of these expenses are described below.

Federal Reserve currency costs include payments to the Board of Governors covering the bank's share of the costs of printing new currency and redemption of unfit large-denomination currency. Also included are charges for the interdistrict and intradistrict shipments of new currency, including shipments from a central depository.

Fees expenses include System Project costs, Directors and Federal Advisory Council costs, and other fees. System project costs totalled about \$18,200 and included fees paid to outside consultants and research firms. For example, the Federal Reserve System participated in a class action suit against major armored carriers, and the Boston Bank paid a pro-rata share of the costs (\$12,725) of collecting statistics, preparing documentation, and obtaining outside legal counsel. Directors and Federal Advisory Council costs totalled \$18,000 and included fees paid to Reserve bank directors for attendance at directors, executive committee, and other meetings; fees paid to members of the Federal Advisory Council; and expenses of the Office of the Secretary of the Council. Other fees included

--\$221,000 for consultants, including labor relations services obtained by the bank during employee unionization efforts;

--\$48,700 for employment agency fees; and

--\$11,100 for speakers.

Other operating expenses not included in the above categories totalled almost \$1.4 million in 1979. Examples of these expenses are listed on the following page.

- \$34,500 for advertising to recruit employees.
- \$125,700 for employee education and tuition expenses, including \$9,000 for procurement of an in-house training package for managers and supervisors.
- \$12,100 for the Federal Reserve Society, which sponsors employee activities such as Christmas parties.
- \$622,800 to subsidize contractor-operated cafeterias and food concessions for employees.
- \$8,500 for dues for the bank's membership in such organizations as the American Institute of Banking and the Building Managers Association.
- \$27,400 for outside medical services, such as physician fees and clinic or hospital charges for physical examinations and ambulance services.
- \$280,000 for procurement of data processing services and software.
- \$17,300 for meetings and conferences, including the costs of meals and facilities. For example, in October 1979, the bank held a conference on the regulation of Federal institutions at a hotel in New Hampshire. The bank paid \$2,183 of the expenses, and \$15,600 was paid from a grant to the bank by the National Science Foundation.
- \$12,000 to firms such as Dunn and Bradstreet for agency credit reports on banks seeking to borrow funds from the bank.
- \$16,300 for procurement of lists of Government publications containing economic forecasts.
- \$53,800 to a contractor for operating a stockroom for office supplies at the contractor's warehouse.

CHAPTER 4

FEDERAL RESERVE BANK PROPERTY AND EQUIPMENT

The Federal Reserve banks own many kinds of property--mostly real estate and equipment--that is used in carrying out normal Reserve bank operations. The aggregate value of their holdings is almost \$854 million. Of this amount, over 70 percent, or \$614 million, is the value of the banks' premises (12 district banks and 25 branch banks).

As in the past, the banks are continuing to acquire property in anticipation of future expansion. Since 1976, new bank buildings have been completed almost yearly, and more land has been acquired. Currently, two new buildings are under construction. When new bank facilities are built, they usually have surplus office space that is rented to tenants until the bank's operations expand to need additional space. Also, the newer bank buildings are decorated with expensive pieces of artwork. The majority of the artwork owned by the Reserve banks was acquired for the newer buildings.

Operating machinery and equipment are also acquired for each new facility. In addition, operating machinery and equipment are occasionally being replaced and upgraded throughout the Federal Reserve System.

FEDERAL RESERVE BANK PROPERTY BY CATEGORY

As previously mentioned, the banks' property holdings are valued at almost \$854 million. The table on the following page summarizes the banks property by major categories.

<u>Item</u>	<u>Total values</u>
Land	\$154,072,910
Buildings	460,024,865
Building machinery and equipment	41,288,446
Operating machinery and equipment:	
Data processing equipment	58,456,728
Furniture and fixtures	16,933,584
Processing and production	22,464,547
General office	3,049,288
Automotive vehicles	942,172
Artwork	1,822,837
Construction in progress	
Amount expended as of 10/31/80	<u>94,798,648</u>
Total	<u>\$853,854,025</u>

Note: The following discussions of each item are an integral part of this presentation and all limitations are noted therein.

Reserve bank property holdings are further summarized by district in appendix V and discussed in more detail below.

LAND

As of October 31, 1980, the Reserve banks owned land valued at \$154 million. Land values are estimated market values (based on local real estate tax assessments) or assessed values except for land on which the new Boston Bank is located. Officials at the Boston Bank stated that the assessment for the new Boston Bank building and surrounding land is a figure negotiated with the city of Boston and is not based on any standard percentage of true market value.

Most of the land is currently being used as an existing site of a district or branch bank. However, with the approval of the Board of Governors, land may be acquired for future use. Since 1976, with Board approval, many parcels of land have been acquired for future expansions. Within this time, four new bank buildings have been completed on building sites acquired for expansion. The table on the following page summarizes property acquisitions and new banks completed since calendar year 1976.

<u>Year</u>	<u>New building occupied</u>	<u>Property acquired for future use</u>
1976	Philadelphia	Kansas City
1977	Boston	Baltimore (branch) Miami (branch) Cleveland Omaha (branch)
1978	Richmond	New Orleans (branch)
1979	-	Jacksonville (branch) Kansas City Little Rock (branch)
1980	Miami (branch)	Data incomplete

The table above shows the most recent property acquisitions only. Prior to 1976, land was purchased which is now being held for future use in Charlotte, New Orleans, Helena, and Houston--all branch locations. At the time of our inquiry, a land purchase was being negotiated in Los Angeles, and land valued at \$9.1 million was pending disposition by the Federal Reserve Bank of New York.

BUILDINGS

The estimated market value of Reserve bank buildings is \$460,024,865. This amount includes the 12 district banks and 25 branch banks. For accounting purposes, bank records show the value of this property as being \$265,216,000, which is cost less depreciation. The difference between these two figures is based on the appreciation of real property owned by the banks, some of which is located on choice sites in urban areas.

New bank premises are presently being built in San Francisco and Baltimore. Although the Miami branch was occupied in July 1980, all of its costs have not been allocated. As of October 31, 1980, about \$94.8 million had been spent on these three construction projects. The banks' records indicate that the total costs to complete these buildings are projected to be about \$142.3 million. In addition to buildings currently under construction, building programs--new facilities or renovations--are planned in New York, Charlotte, Birmingham, and Helena.

In addition to land and buildings mentioned above, the Boston District owns a site and facility at Amherst, Massachusetts. The Amherst building is an underground records storage and emergency operations facility at a former military installation. The bank purchased the facility for \$60,000 in 1972, and it is now assessed at \$291,580 for tax purposes. A bank official said the facility has extremely limited marketability.

All Reserve bank operations are not physically housed in bank-owned facilities. For example, all 11 RCPCs occupy leased space for their operations. In addition, some district and branch banks also occupy some rental office space. For 1980, the cost to the banks for all rented space was estimated to be over \$7.2 million.

Not only do the banks rent from others, but 9 of the 12 districts reported that they lease space to outsiders. For 1980, rental income was estimated to be almost \$5.2 million. Most of the rental income is generated from space leased in the newer bank buildings. The newer buildings are being built with surplus office space in anticipation of future growth. Until such growth occurs, the space is leased to outsiders. For example, about 21 percent of the new Federal Reserve Bank of Boston is currently leased to outside tenants. The chart below shows rental income being generated from the three newest district bank buildings.

	<u>Rental income</u>
Boston	\$2,930,393
Richmond	\$1,008,314
Philadelphia	\$ 545,460

BUILDING MACHINERY AND EQUIPMENT

Building machinery and equipment include the machinery and equipment attached to the building, such as the heating and air conditioning systems. The net book value of building machinery and equipment was \$41,288,446 as of October 31, 1980.

OPERATING MACHINERY AND EQUIPMENT

Operating machinery and equipment are those items of machinery and equipment used in the conduct of normal Reserve bank operations. Such items are constantly being replaced and upgraded throughout the Federal Reserve System. These changes are necessary due to the requirements of the Monetary Control Act of 1980 as well as for System improvements in general. The act requires in part that Reserve bank services be priced and that depository institutions report financial information to the Federal Reserve System. The net book value of all operating machinery and equipment at October 31, 1980, was \$101,846,319. The table below summarizes operating machinery and equipment by category.

<u>Category</u>	<u>Net book values</u>
Data processing equipment	\$ 58,456,728
Furniture and fixtures	16,933,584
Processing and production	22,464,547
General office	3,049,288
Automotive vehicles	<u>942,172</u>
Total	<u>\$101,846,319</u>

Data processing equipment consists of computers and related equipment. Its value is 57 percent of all operating machinery and equipment. Furniture and fixtures include items of office furniture such as desks and chairs. Currency verification equipment and check processing equipment are examples of processing and production equipment. The category of general office equipment includes items such as typewriters and calculators. Passenger cars, vans, and trucks owned by the banks comprise the \$942,172 worth of automotive vehicles.

In 1975 the banks instituted a new policy of capitalizing individual pieces of operating (production) equipment that cost more than \$10,000. In the past, the cost of such equipment has been charged to expenses in the year of purchase. Later in January 1977, the banks began to capitalize the cost of furniture, equipment, and artwork. Because of these accounting changes, it is probable that some items of operating machinery and equipment purchased prior to the effective date of the accounting changes are not included in the above table.

ARTWORK

Decorative art objects--paintings, sculptures, etc.--owned by the Reserve banks are valued at their original cost: \$1.8 million. The cost of individual objects varies from minimal amounts to over \$330,000. Although some individual

pieces of artwork may have appreciated over time, we did not obtain estimated market values for them. However, we did observe that the newer banks are buying the more expensive artwork.

The table below shows artwork valued in excess of \$50,000 owned by the banks.

<u>Bank</u>	<u>Item</u>	<u>Cost</u>
Philadelphia	Mobile	\$332,000
Philadelphia	Sculpture	175,000
Boston	Painting	109,573
Miami	Sculpture	87,000
Boston	Painting	68,643
Richmond	Sculpture	65,000
Boston	Tapestry	55,261

All of the banks' artwork may not be disclosed in the \$1.8 million figure shown in appendix V. This is due in part to the banks' former practice of not capitalizing artwork costing less than \$10,000. Also, other pieces of artwork are being accounted for in other property categories. For example, only \$1,355 worth of artwork is shown in appendix V for the Cleveland District. However, other sources indicate that more artwork exists. A 1976 Staff Report of the Subcommittee on Domestic Monetary Policy (House Committee on Banking, Finance, and Urban Affairs, formerly the House Committee on Banking, Currency, and Housing) indicates that the Cincinnati branch of the Cleveland District had nearly \$63,000 worth of art objects. This consisted of over \$14,000 for a mural composed of historical engraving plates; \$22,600 for a bronze eagle; and \$26,000 for a stainless steel geometric sculpture. We asked Board officials if they could explain the difference. We were told that those three pieces of artwork just mentioned had been capitalized to the building account since they were attached to the building in some way.

CHAPTER 5

SEVERAL INTERRELATED FACTORS NEED TO BE CONSIDERED

BEFORE CLOSING THE FEDERAL RESERVE BANKS

The Federal Reserve System was established for various reasons. The particular functions performed by the System have developed over time in recognition of real needs and demands. Although the nature of the banking industry has changed since 1913, it is not perfectly clear that the changes have rendered the regional system of Federal Reserve banks obsolete.

A decision to eliminate the Federal Reserve banks should not be predicated solely on the possible savings of current operating costs or the possible gains from the sale of property and equipment. Rather, such a decision should be based on a careful consideration of a number of interrelated factors: transfer costs, need for a central bank to provide services, realizable versus apparent savings, feasibility of transfer, etc. Given the time established for our review, we have not conducted studies of the feasibility of transferring or eliminating each of the functions now performed by the Federal Reserve banks. We have, however, attempted to identify those factors which would have to be addressed in any such studies. For convenience of presentation, we discuss these factors in two rather loose categories: savings and cost factors and policy factors.

Each category is first discussed in terms of its impact on the System as a whole and then as it applies to each of the major Federal Reserve bank services.

SAVINGS AND COST FACTORS

The 12 Federal Reserve banks spent \$790 million in 1980 and hold property worth almost \$854 million. Were the banks closed down, however, the Government might not save the total \$790 million, nor would it likely gain all \$854 million from the sale of bank property. In most cases, the functions performed by the banks would have to be performed by someone else: the Board, other Government agencies, or private industry. If these functions were performed by the Board or other Government agencies, the savings to the Government would be minimal, if any at all. The disposal of real estate and property might not bring full market value, and some of the proceeds would have to be used to pay off the Federal Reserve banks' stockholders.

A portion of bank expenditures support
the operations of the Board of Governors

In accordance with section 10 of the Federal Reserve Act, the Federal Reserve banks are assessed for the operating costs of the Board of Governors. In 1979, these assessments amounted to \$50,530,000; in 1980, they totalled \$62 million. Closing the Federal Reserve banks would not eliminate the amount required to operate the Board of Governors.

Pricing of Federal Reserve services
may have two effects

The Monetary Control Act of 1980 requires the Federal Reserve to charge for many of the services that it has been giving its member banks for no charge. The pricing has two potential effects: (1) the costs of these services will be absorbed by the users of those services and (2) private industry may compete with the Federal Reserve in providing some or all of the services to depository institutions.

The Monetary Control Act of 1980 requires the Federal Reserve to price most of the services it currently provides to member banks. The act also requires nonmember banks, as well as credit unions, thrift institutions, and savings and loan associations to establish reserve accounts with Federal Reserve banks. As a result, Federal Reserve services will be available to them on a fee basis as they will for member banks. Officials at the Board of Governors and the Boston Federal Reserve Bank have indicated that they do not know exactly how pricing will affect them.

Pricing could reduce net operating costs

As required by the act, the Board has published a set of pricing principles and a proposed schedule of Federal Reserve fees dealing with those services to be priced. The services to be priced, as listed in the act, are

- currency and coin service,
- check clearing and collection services,
- wire transfer services,
- automated clearinghouse services,
- settlement services,

- securities safekeeping services,
- Federal Reserve float (a form of credit resulting from check clearing activities based on the time it takes Reserve banks to credit the reserve deposits of member banks for the amount of each check they deposit, and to deduct the amount of each check from the reserve deposits of banks on which the check is drawn), and
- any new services which the Federal Reserve System may offer.

The pricing of Federal Reserve services is regarded as a means of encouraging competition and efficiency in the provision of such services. The Congress therefore charged the Board with adopting pricing principles that "give due regard to competitive factors and the provision of an adequate level of such services nationwide."

The Monetary Control Act dictates that the Federal Reserve's pricing is to be explicit and that, over the long run, the fee schedule should recover total costs for all priced services. If the volume of Federal Reserve business declines as a result of pricing, the Federal Reserve is required to reduce the operating budgets of the Federal Reserve banks in amounts commensurate with any actual or projected decline in the volume of services provided by those banks. Because of fixed costs, a reduction in volume would likely result in an increase in the per-unit cost for services.

In one sense then, the pricing requirements of the Monetary Control Act mean that, once the charging for services has begun, any estimate of savings resulting from a closing of the Federal Reserve banks would have to recognize the offsetting income from pricing. In effect, pricing will mean a reduction in the net operating costs for each Federal Reserve bank. If the pricing schedules prepared by the Federal Reserve conform to the requirements of the act, all of the costs to provide the priced services should be recovered.

Competition may reduce service levels

The competitive effects of pricing are less certain. Because some of the services to be priced are currently offered in correspondent-respondent type banking relationships, it is very likely that banks will be comparing the cost and quality of the Federal Reserve's services with those of competitors before deciding on a vendor. Check clearing and collection, wire transfers, and limited automated

clearinghouse services are among the services already being provided by large correspondent banks. However, these services are generally not on a nationwide basis and may at some point tie into the Federal Reserve's system for completion. Pricing may have little impact on other services such as the coin and currency services. According to Federal Reserve officials, few private sector firms, including banks, currently have large enough vault capacity and security systems, let alone the currency destruction equipment necessary for large-scale currency operations.

It is conceivable that large correspondent banks will compete with the Federal Reserve for services primarily in large urban centers. The less lucrative markets, mainly rural areas, may not be well serviced, if at all, by the private sector due to the economies of scale in providing them services. The Federal Reserve may well be left with providing its services at higher per-unit cost to small banks that can least afford to pay for necessary banking services. If this occurs, these banks' customers will probably pay more for necessary banking services due to increased cost to the banks. Furthermore, any loss of member bank business by the Federal Reserve could possibly be offset by new business from nonmember institutions since the Federal Reserve's services will be available to them.

It is not certain at this time that the pricing of Federal Reserve services will result in sufficient private industry competition to eliminate the Federal Reserve as a supplier. Given some of the fixed costs involved in some services (vaults, currency destruction equipment, for example), it may be a long time, if ever, before private industry effectively competes for some Federal Reserve functions. Nonetheless, the following questions are pertinent to any considered replacement of the Federal Reserve with private service suppliers.

- Should private industry perform any or all of these services?
- Can private industry provide a comparable level of service?
- Should the Federal Reserve provide a last resort service capability?
- Should the Federal Reserve be able to provide full nationwide service in the event of an emergency?

Sale of property may not produce
full market value

The estimated value of potentially disposable Federal Reserve property is \$853.9 million. Of this, \$614 million, or 70 percent, is the estimated value of land and buildings. The Federal Reserve Banks of Boston and Richmond have recently disposed of old bank buildings. Their experiences indicate that such sales are time-consuming and may not always result in sales proceeds anywhere near estimated market values or even sales prices.

Old Richmond Bank sold to State

The Federal Reserve Bank of Richmond moved from its old building at 100 North 9th Street to its new one at 701 East Byrd Street in July 1978. The bank began attempting to sell the old building on April 1, 1977. One approach was advertisements in the Wall Street Journal and local newspapers. The advertisements, which ran 1 day per week for 4 weeks, asked for bids on the land and building. No bids were received.

The old bank site and a parcel of property being held for future use, which had a value of about \$1.5 million, were sold to the State of Virginia. The Federal Reserve Bank of Richmond received \$4,000,000 plus a parcel of land valued at \$133,000 near its new building. The Federal Reserve Bank of Richmond did not have an appraisal done on the old site prior to its sale.

Old Boston Bank to become a hotel

When the Federal Reserve Bank of Boston moved to its present location on Atlantic Avenue in January 1978, it vacated buildings located on Pearl Street in Boston. The Pearl Street site consisted of 1.8 acres of land; the original bank building, completed in 1923; an addition completed in 1953; and a temporary coin annex built in 1973. The total cost of the site was about \$13.4 million.

The bank had the Pearl Street site independently appraised in May 1975. The appraisal report stated that the property would be best used by demolishing the existing buildings and constructing a high-rise office tower. The appraisal, given that use, was \$5.5 to \$6.5 million, excluding demolition costs. The appraised value dropped to \$2.5 million if the existing buildings were to remain.

Disposal of the property was constrained by the Boston Landmarks Commission's objection to demolition of the 1923 bank building. The need to retain the 1923 building limited the marketability of the entire block, but the Commission's objection was not overcome. Also, the city of Boston opposed construction of a Federal office building on the site, and, in 1976, the bank learned that the General Services Administration would not be purchasing the property.

The bank offered the Pearl Street site for sale through a Boston real estate firm in May 1976. The bank sold the 1953 addition and coin annex buildings and associated land in December 1978 for \$2.2 million. The buildings have since been demolished and a high-rise office building is under construction on the site. The 1923 bank building and land was sold for \$1.6 million in March 1979, nearly 3 years after it was offered for general sale and 4 years after it was appraised. The building is being turned into a luxury hotel.

The costs associated with the two sales totalled \$217,900. The Federal Reserve Bank of Boston realized \$3,582,100 from the sale of the Pearl Street site. The net proceeds were about \$815,000 less than the 1978 book value of the property, and \$1.9 to \$2.9 million less than the 1975 appraisal for the vacant land.

Of the 12 Federal Reserve banks, 8 were constructed before or during the 1930s (a replacement for one is being constructed). These buildings may be difficult to sell or may bring proceeds less than market or book values. The proceeds from sales of other property, such as furniture, fixtures, equipment, and art objects, would be determined by the market for such items at the time and place of sale.

Two more matters to consider

Two other matters must be considered when discussing the sale of Federal Reserve bank property. First, nine districts are leasing space to other organizations. Sale of those buildings would result in some loss of rental income. Second, section 7 of the Federal Reserve Act states

"* * * Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States * * *."

Therefore, a portion of the proceeds from the sale of Federal Reserve bank property would be returned to each Reserve bank's stockholders. As of December 31, 1980, the par value of all outstanding Federal Reserve bank stock totalled \$2.4 billion.

POLICY FACTORS

The Federal Reserve System was created as a means of centrally controlling the Nation's money supply and providing central banking services to commercial banks. The regional aspect of the System--the Federal Reserve banks--was established, in part, in recognition of the diversity of the Nation and its economy. In addition to ensuring that the central bank was at least exposed to regional experiences and needs, the 12 Federal Reserve banks provide for relatively localized contact between commercial banks and their central bank. Beginning with the original Federal Reserve Act, and continuing with the many modifications to it, the Federal Reserve System composed of a Board of Governors and 12 regional banks has been confirmed as a creation of national policy.

The elimination of the Federal Reserve banks would represent a fundamental change in policy with regard to the operation of the Nation's central bank. Such a decision would have to be predicated on a determination that the present system is not effectively accomplishing its objectives; or that the present system is not adequate for the economy or the industry of today; or that private industry or other Government agencies would provide services as effectively, or more so, at lower cost. It is not obvious that any of these conditions exist. Considerable additional study would have to be done to determine whether or not the abovementioned conditions exist and to answer certain questions:

- What would the central bank, the Government, or the banking industry gain or lose through elimination of the Federal Reserve banks?
- Would elimination of the Federal Reserve banks increase the potential for undesirable banking practices?
- Would regional banking needs be met without the Federal Reserve banks?

MONETARY AND ECONOMIC POLICY SERVICE LINE

Of all the Federal Reserve bank functions, the System considers the support of monetary and economic policy to be the most important. Each Federal Reserve bank has a research department which contributes to policy formulation. The Federal Reserve Bank of New York translates policy into action through its buying and selling of Government securities. The full amount of expense attributable to this service line would not be saved were the Federal Reserve banks closed. It is not clear what would be lost were the regional perspectives provided by the Federal Reserve banks no longer available.

Elimination of function would not eliminate all costs

The Federal Reserve banks spent \$53.5 million in 1980 on monetary and economic policy activities. The largest part of this was for operating the banks' research departments. About \$6.9 million, or 13 percent of the total, represents the New York Bank's expenditures for its open market operations.

It is possible that some of the Federal Reserve bank research base would have to be added to the Board of Governors' research staff. Savings would be reduced to the extent to which this had to be done. Such a transfer could cost more because of the Federal Reserve banks' localized pay systems--salaries are generally higher for Board staff.

Closing the Federal Reserve Bank of New York would mean a transfer of the open market trading operation, most likely to the Board. Such a move, if feasible, would not save the Government any money however. Because of transfer and set-up costs, that move could result in more cost to the Government during the transfer year.

Federal Reserve banks provide regional economic perspective

The elimination of the Monetary and Economic Policy Service Line would involve consideration of two policy issues:

- (1) Do the Federal Reserve banks provide valuable support to monetary policy formulation and implementation?
- (2) Could the functions performed by the banks be done by someone else?

The information for monetary policy decisions, short-term and long-term, is based on closely monitored developments in the money and capital markets. All Federal Reserve banks contribute to the wealth of economic data used by the Board of Governors and the Federal Open Market Committee in monitoring monetary policy. The perspective provided by the Federal Reserve banks is regionalized, and may not easily be replaced by other sources, such as private research firms or universities. Boston Federal Reserve Bank officials, for example, told us that their bank is the only source, at least in their district, for the type of research it does. Some of the research the banks conduct is sensitive and confidential. Board officials said that certain data needs to be kept confidential because of its potential effect on financial markets. Thus, Board officials would rather have System officials handling it.

The research capability of the Reserve banks also serves to augment the Board's own research staff. The banks perform special studies requested by the Board, the Congress, and the President. The banks are a ready resource for meeting urgent data requests.

The Federal Reserve Bank of New York's open market operation is a unique one within the System. The operation is performed by the New York Bank because the private dealers involved are located in New York, and because New York City is the Nation's banking and financial capital. Federal Reserve officials directly responsible for open market operations meet with the dealer firms on a rotating basis every business day. The dealers discuss market developments as well as matters of particular interest to their firms. This interaction is possible because both parties are located in New York City. The transfer of this function to Washington is theoretically possible, but Federal Reserve officials do not believe it to be very practical.

U.S. TREASURY AND GOVERNMENT
AGENCIES SERVICE LINE

Federal Reserve banks act as the Government's principal fiscal agents. Under the general supervision of the Treasury, the banks maintain the Treasury's bank accounts, process Government checks, and administer the sale and redemption of Government securities. These services cost \$93.4 million in 1980--\$56.4 million was provided by the Treasury and others as reimbursement. If the Federal Reserve banks were closed, the Government would not save any money as these functions would still have to be performed. The elimination of the service also hinges on whether another provider would provide better or more economical services.

The Government would still pay a
fiscal agent were the Federal
Reserve banks gone

The U.S. Treasury and Government Agencies Service Line would not be a source of much savings, if any at all, were the Federal Reserve banks closed because

--for 1979 and 1980, an average of 61 percent of the costs are reimbursed by the Treasury and other Federal agencies and

--similar or greater costs would be incurred if the Treasury served as its own bank or utilized the commercial banking system.

Closing the Federal Reserve banks would not alleviate the need for someone to perform the fiscal agency functions for the Government. Were the functions shifted to one or more Government agencies (including the Treasury itself), no costs would be saved and start-up costs could prove enormous. Utilizing commercial banks for these services could result in higher costs because the commercial providers would be adding an element of profit, something which is not present in the Federal Reserve cost.

Another fiscal agent may not be practical

Section 15 of the Federal Reserve Act, as amended, authorizes the Federal Reserve banks, when required by the Secretary of the Treasury to

"* * * act as fiscal agents of the United States; and the revenues of the Government * * * may be deposited in such banks, and disbursements may be made by checks drawn against such deposits."

The Federal Reserve has also been designated as depository and fiscal agent for several international agencies (such as the Inter-American Development Bank).

The fiscal agent functions were originally performed by the Treasury. In 1920, the Congress gave the Secretary of the Treasury authority to delegate fiscal agent and depository functions to the Federal Reserve banks. The Reserve banks, although few in number, were geographically dispersed to facilitate the handling of Treasury functions. The Federal Reserve has since developed an elaborate communications system and techniques for handling the large volume of Government business. It is doubtful that any bank,

or group of banks, or private facility could readily duplicate the System's role as the Government's banker with the same degree of efficiency and effectiveness. Another point to be considered is whether the Treasury would be willing to have someone else transact its business.

Federal Reserve officials told us that the Treasury Department would rather delegate more functions to the Reserve banks than do them itself. The reason for Treasury's stand is that the Reserve banks do a good job of handling the Government's fiscal matters. These officials also indicated that the Treasury could not readily perform some of these functions because it lacks adequate nationwide communication links.

The need for stringent controls over Government transactions may make the use of commercial banks impractical. Federal Reserve officials expressed concern over whether commercial banks had controls and security to equal those of the Federal Reserve.

FINANCIAL INSTITUTIONS AND THE PUBLIC SERVICE LINE

The Federal Reserve banks have been providing services like check processing and clearing and currency and coin distributing to its member banks since 1913. With enactment of the Monetary Control Act of 1980, all depository institutions will have access to these services. The act also directed that all depository institutions using these services will have to pay for them. Thus, when the required fee schedule is in place, the cost of providing these services will have been shifted from the Government (as represented by the Federal Reserve) to the users of those services and eventually to those users' customers. Whether these same services will be provided more effectively and efficiently by private industry is debatable.

Cost savings may be illusory

The Federal Reserve banks are required to begin charging for the services they provide under this service line by September 1, 1981. If the fees charged meet the requirements of the Monetary Control Act of 1980 (see p. 34), nearly all costs incurred in providing those services will be reimbursed. Thus, closing the Federal Reserve banks would not save the Government these costs, because they would already have been paid for by the service recipients.

Ability of others to provide same services uncertain

The largest part of the Federal Reserve banks' services to banks involves the clearing of checks. Yet, the Federal Reserve System only processes 47 percent of the Nation's checks. The private sector handles the remainder through private clearinghouses, correspondent banks, and direct exchange between commercial banks. The Federal Reserve is a major supplier of regional and nationwide check transportation and clearing. Also, 31 of the 32 automated clearinghouses in the country are operated by the Federal Reserve System. Because private industry is already involved in clearing the majority of the country's checks, this Federal Reserve service may be particularly vulnerable to increased private sector competition. However, private organizations may be unwilling to assume the Federal Reserve's nationwide services or to provide services to remote or low-population areas which would possibly be unprofitable.

The pricing of services may have little impact on the Federal Reserve as the major supplier of currency and coin. The start-up costs to provide currency and coin storage and delivery, especially on a nationwide basis, may be prohibitive. The private sector may be unwilling to acquire the necessary vault space and security systems needed to conduct such a venture even on a regional basis.

The Federal Reserve provides electronic funds transfer facilities to Federal agencies. The 40,000 mile telecommunications system called "FEDWIRE" interconnects Federal Reserve banks, branches, and offices with over 450 commercial banks. The Department of the Treasury is tied directly into the network. Billions of dollars are moved through the network each year. Were the Federal Reserve banks closed down, some alternative to FEDWIRE would be needed.

The Federal Reserve banks hold and maintain the reserve accounts that member banks, and soon all depository institutions, must maintain. Since Federal Reserve banks are not competitors of commercial institutions, they are the most likely depositories of banks' reserves. Some banks may be unwilling to maintain their reserves or "due from" accounts with banks they consider to be competitors. Without the Federal Reserve banks, some new network of reserve account maintenance allowing for transfers, settlements, and security would have to be devised. Commercial banks may not be desirable candidates to provide such networks, and other Government agencies would probably be unwilling or unable to do so.

SUPERVISION AND REGULATION SERVICE LINE

The supervision and regulation of banks and bank holding companies is a basic Federal Reserve bank function. Federal Reserve banks employ the staff who examine and supervise State member banks and inspect bank holding companies. Federal Reserve bank personnel also contribute to the formulation of regulations which apply to all member banks. Were the Federal Reserve banks closed, this function would have to be absorbed by another agency, possibly the Comptroller of the Currency or the Federal Deposit Insurance Corporation. Such a transfer would save money; however, it is not clear that such a transfer should be made.

Costs would be lowered by eliminating this function

Like the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation also examine, supervise, and regulate banks. Each has a regional structure and examiner force devoted to overseeing its constituent banks. Thus, either agency would be a likely candidate to absorb the examination, supervision, and regulation responsibilities of the Federal Reserve. Since both organizations derive their operating funds from assessments (for examinations or insurance) on their constituent banks, Government costs represented by this service line would be reduced.

Consolidation of bank regulation is a complex, controversial issue

The idea that bank regulation should be done by one or two agencies instead of three has surfaced many times since the third agency--the Federal Deposit Insurance Corporation--was created in 1933. The agencies have overlapping authorities and they do similar things. Yet they do not necessarily duplicate one another because they concentrate on different constituencies:

- The Comptroller of the Currency supervises national banks.
- The Federal Reserve supervises State-chartered banks which are members of the System.
- The Federal Deposit Insurance Corporation supervises State-chartered banks which have Federal deposit insurance but which are not Federal Reserve System members.

Various consolidation proposals would have any one of the agencies surviving, two of the agencies surviving, or a new agency being formed. There are a number of arguments for and against consolidation. In a 1977 Staff Paper, 1/ we summarized arguments proposing that a single agency might be able to

1. handle problem or failing banks more effectively,
2. deal with bank holding companies more effectively,
3. operate more efficiently,
4. be more accountable to the Congress and the public,
5. treat all banks more uniformly, and
6. integrate bank supervision and monetary policy.

On the other hand, consolidating the agencies into a single agency runs the risk of

1. removing a system that works well,
2. excessively centralizing power,
3. restricting innovativeness, and
4. weakening the dual banking system.

We have found in some reviews that the three-agency structure has caused some problems in coordinating examination and supervisory approaches. However, the Federal Financial Institutions Examination Council was created in 1978 and has helped to promote and facilitate interagency cooperation and coordination on supervisory matters. In a recent report, 2/ we recommended that the Council establish a task force to determine the feasibility of consolidating the examination forces of the Federal regulatory agencies.

Although eventual consolidation of bank regulation responsibilities remains a possibility, the Congress has not yet been given a compelling reason to effect such a change.

1/The Debate on the Structure of Federal Regulation of Banks, OCG-77-2, Apr. 14, 1977.

2/"The Federal Structure for Examining Financial Institutions Can Be Improved" (GGD-81-21, Apr. 24, 1981).

CONCLUSIONS

A large portion of the current Federal Reserve bank operating expenses would still be incurred if the banks were to be eliminated. In most cases, the various services or functions will need to be performed by someone else: the Board, another regulatory agency, another Federal agency, or private industry. In general, shifting of functions from the Federal Reserve banks to elsewhere in the Government saves the taxpayer nothing.

The estimated market value of Federal Reserve bank property may not be what the Government would realize from its sale. As the Boston and Richmond experiences show, many factors interact to determine how soon a buyer can be found and how much a buyer would be willing to pay.

The hypothetical closing of the Federal Reserve banks raises a number of important service and policy issues. The roles of the Federal Reserve banks as formulators of monetary policy, as arms of the central bank, and as commercial bank supervisors have been shaped and refined and have grown for nearly 70 years. It is not apparent that any one alternative is ready or able to replace them. Even on a service-by-service basis, no obvious alternative surfaces which clearly answers all of the policy and service questions.

AGENCY COMMENTS

The Federal Reserve was in basic agreement with the issues and our conclusions on the factors to consider if the Reserve banks were closed, or functions abolished or transferred. The Federal Reserve's comments are reproduced in full in appendix VI.

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225-6247

October 6, 1980

The Honorable Elmer B. Staats
 Comptroller General of the United States
 General Accounting Office Building
 441 G Street, N.W.
 Washington, D. C. 20548

Dear Mr. Staats:

The nation's continuing huge budgetary deficits, which are forcing cutbacks in many highly desirable programs, require that we reexamine every aspect of federal operations to determine where economies can be made without loss of essential government functions.

The Domestic Monetary Policy Subcommittee of the House Committee on Banking, Finance and Urban Affairs has approved a bill to abolish the Federal Open Market Committee and lodge responsibility for monetary policy where it belongs -- with the seven members of the Board of Governors. Monetary policy decisions are clearly, and constitutionally, a basic governmental function. They should be made by the Governors of the Federal Reserve, who are appointed by the President and confirmed by the Senate, not by banker-elected Presidents of the 12 Reserve Banks who now sit on the FOMC.

In addition to this change, the entire Federal Reserve System requires re-examination. The System was established in 1913 to serve the banking needs of that era. Important questions now arise: Is the vast Federal Reserve bureaucracy that has developed still needed to serve the essential functions of a central bank? Should its bank regulatory functions be transferred to the Comptroller of the Currency and the Federal Deposit Insurance Corporation? Could its vast clerical and check-clearing services be carried out better by the private sector, where competition would produce cost-saving efficiencies?

The Federal Reserve System currently costs the taxpayers more than \$1 billion annually to operate, even without considering its enormous investment in capital facilities. The System has 12 regional Reserve Banks, 25 branches, 48 check-clearing facilities and 22,000 employees. Its banks and branches occupy some of the choicest and most valuable real estate in our urban centers. In recent years, the New York Federal Reserve Bank has purchased additional prime land next to Wall Street, and the San Francisco Bank has assembled a large land package.

The Honorable Elmer B. Staats
October 6, 1980

Page Two

I request that the General Accounting Office undertake a study of the Federal Reserve System:

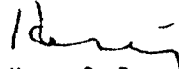
- to determine the estimated market value of all Reserve Bank real estate (land, buildings, and construction in process) and all other property such as furniture and equipment;
- to determine all operating expenses and categorize them by functions such as check-clearing, currency storage, bank supervision, fiscal agency operations, and research.

Also, for a Reserve Bank which you choose, conduct as detailed an analysis as is feasible of all operating expenses. The report should include the nature of expenses which would commonly be classified as administrative.

Your views would also be appreciated as to significant factors the Committee should consider in its deliberations of Bank functions which might be abolished or transferred to other government agencies or the private sector.

I look forward to the results of your study and anticipate a preliminary, if not final, report by no later than February 1, 1981.

Sincerely,



Henry S. Reuss
Chairman

FEDERAL RESERVE BANK OPERATING EXPENSES
BY SERVICE LINE--CALENDAR YEAR 1979
(000 omitted)

<u>Service Lines</u>							
<u>Bank</u>	<u>Monetary and Economic Policy</u>	<u>U.S. Treasury and Government Agencies</u>	<u>Financial Institutions and the Public</u>	<u>Supervision and Regulation</u>	<u>Total expenses</u>	<u>Reimbursements and recoveries</u>	<u>Net expenses</u>
Boston	\$ 2,357	\$ 4,607	\$ 40,753	\$ 4,672	\$ 52,389	(\$ 6,079)	\$ 46,310
New York	\$14,573	\$19,816	\$108,171	\$16,958	\$159,518	(\$15,533)	\$143,985
Philadelphia	\$ 2,513	\$ 4,294	\$ 28,513	\$ 3,662	\$ 38,982	(\$ 3,325)	\$ 35,657
Cleveland	\$ 1,659	\$ 6,651	\$ 37,045	\$ 4,254	\$ 49,609	(\$ 5,491)	\$ 44,118
Richmond	\$ 1,995	\$ 5,597	\$ 52,757	\$ 5,001	\$ 65,350	(\$ 4,588)	\$ 60,762
Atlanta	\$ 2,207	\$ 6,857	\$ 55,746	\$ 4,419	\$ 69,229	(\$ 6,981)	\$ 62,248
Chicago	\$ 2,687	\$10,718	\$ 74,392	\$ 7,801	\$ 95,598	(\$ 7,651)	\$ 87,947
St. Louis	\$ 1,892	\$ 4,179	\$ 29,206	\$ 3,214	\$ 38,491	(\$ 3,371)	\$ 35,120
Minneapolis	\$ 1,506	\$ 2,201	\$ 23,549	\$ 2,438	\$ 29,694	(\$ 2,410)	\$ 27,284
Kansas City	\$ 1,550	\$ 4,902	\$ 37,668	\$ 5,511	\$ 49,631	(\$ 4,232)	\$ 45,399
Dallas	\$ 1,880	\$ 3,697	\$ 32,034	\$ 3,427	\$ 41,038	(\$ 2,551)	\$ 38,487
San Francisco	\$ 3,424	\$10,018	\$ 52,929	\$ 6,395	\$ 72,766	(\$ 6,588)	\$ 66,178

FEDERAL RESERVE BANK OPERATING EXPENSES
BY SERVICE LINE--CALENDAR YEAR 1980 (note a)
(000 omitted)

Bank	<u>Service Lines</u>						<u>Net expenses</u>
	<u>Monetary and Economic Policy</u>	<u>U.S. Treasury and Government Agencies</u>	<u>Financial Institutions and the Public</u>	<u>Supervision and Regulation</u>	<u>Total expenses</u>	<u>Reimbursements and recoveries</u>	
Boston	\$ 3,740	\$ 4,851	\$ 44,511	\$ 5,332	\$ 58,434	(\$ 6,942)	\$ 51,492
New York	\$17,245	\$22,379	\$120,202	\$20,512	\$180,338	(\$17,880)	\$162,458
Philadelphia	\$ 3,045	\$ 5,023	\$ 31,713	\$ 4,656	\$ 44,437	(\$ 4,070)	\$ 40,367
Cleveland	\$ 2,249	\$ 6,784	\$ 40,113	\$ 5,112	\$ 54,258	(\$ 5,550)	\$ 48,708
Richmond	\$ 2,856	\$ 6,367	\$ 58,539	\$ 6,179	\$ 73,941	(\$ 5,733)	\$ 68,208
Atlanta	\$ 2,957	\$ 7,131	\$ 60,201	\$ 5,164	\$ 75,453	(\$ 5,820)	\$ 69,633
Chicago	\$ 4,566	\$11,741	\$ 80,261	\$10,380	\$106,948	(\$ 8,513)	\$ 98,435
St. Louis	\$ 2,425	\$ 4,610	\$ 34,157	\$ 3,739	\$ 44,931	(\$ 3,676)	\$ 41,255
Minneapolis	\$ 2,275	\$ 2,534	\$ 27,398	\$ 3,357	\$ 35,564	(\$ 2,424)	\$ 33,140
Kansas City	\$ 2,257	\$ 5,660	\$ 40,600	\$ 7,169	\$ 55,686	(\$ 4,568)	\$ 51,118
Dallas	\$ 3,118	\$ 4,156	\$ 36,597	\$ 4,808	\$ 48,679	(\$ 2,798)	\$ 45,881
San Francisco	\$ 6,817	\$12,186	\$ 57,552	\$10,647	\$ 87,202	(\$ 7,723)	\$ 79,479

a/1980 figures represent actual expenses for the first three quarters and estimated expenses for the fourth quarter.

OPERATING EXPENSES FOR THE BOSTON FEDERAL RESERVE BANK
DISTRICT FOR CALENDAR YEARS 1979 AND 1980

Type of expense	<u>1979</u> <u>Amount</u>	<u>1980 (note a)</u> <u>Amount</u>
Personnel:		
Officers salaries	\$ 1,796,500	\$ 1,963,000
Employees salaries	21,048,100	23,075,600
Retirement and other benefits	6,866,800	7,651,900
Other personnel expenses	225,700	151,900
Total personnel	<u>29,937,100</u>	<u>32,842,400</u>
Materials and supplies	2,153,700	2,327,800
Equipment:		
Equipment rentals	1,745,000	1,689,100
Equipment depreciation	819,700	1,151,700
Equipment repairs and maintenance	407,000	635,800
Total equipment	<u>2,971,700</u>	<u>3,476,600</u>
Shipping:		
Postage	632,000	663,000
Other shipping	<u>3,539,600</u>	<u>4,293,800</u>
Total shipping	<u>4,171,600</u>	<u>4,956,800</u>
Travel	557,200	693,100
Communications	788,000	822,300
Building:		
Building insurance	18,400	26,000
Taxes on real estate	2,018,100	2,923,000
Property depreciation	2,211,300	2,345,700
Utilities	1,521,600	1,807,200
Rent	433,000	461,300
Other building expense	<u>383,600</u>	<u>472,200</u>
Total building	<u>6,586,000</u>	<u>8,035,400</u>
Other:		
Federal reserve currency	3,695,000	3,650,300
Fees	318,400	346,100
All other	<u>1,371,100</u>	<u>1,427,900</u>
Total other	<u>5,384,500</u>	<u>5,424,300</u>
Contra expenses (note b)	<u>(160,700)</u>	<u>(145,000)</u>
Total expenses	<u>\$52,389,100</u>	<u>\$58,433,700</u>

a/Amounts for 1980 consist of actual expenses for January through September plus budgeted expenses for October through December.

b/This item consists of miscellaneous expenses chargeable to future operations; for example, printing and duplicating costs for supplies not immediately issued to users.

SUMMARY OF FEDERAL RESERVE BANK PROPERTY BY BANK
AS OF OCTOBER 31, 1980

Banks	Land (note a)	Buildings (note a)	Building machinery (note b)	Operating equipment (note b)	Furniture and fixtures (note b)	Automotive vehicles (note b)	Artwork (note c)	Construction In Progress	
								Amount expended	Projected total
Boston	\$ 21,727,474	\$ 78,600,444	\$ 7,272,190	\$ 5,247,957	\$ 2,961,625	\$ 45,152	\$ 501,173	\$ -	\$ -
New York	41,774,325	64,901,288	2,558,676	18,369,730	1,882,859	77,372	15,344	-	-
Philadelphia	4,300,000	60,116,000	3,835,040	5,318,334	1,213,553	46,794	520,700	-	-
Cleveland	10,240,976	36,944,739	3,770,728	3,145,768	864,198	68,949	1,355	-	-
Richmond	12,233,052	62,245,425	14,068,083	5,081,788	3,386,831	144,899	421,354	23,385,217	36,712,309
Atlanta	11,760,517	25,924,096	369,689	6,147,930	645,102	99,696	164,096	16,450,309	18,133,000
Chicago	13,818,306	24,707,351	1,022,482	6,794,423	860,341	41,818	3,722	-	-
St. Louis	5,478,249	13,990,778	1,300,349	3,159,571	316,728	75,411	10,914	-	-
Minneapolis	2,259,426	30,920,645	3,664,817	5,098,696	415,682	104,678	136,848	-	-
Kansas City	7,262,300	15,512,600	1,620,424	7,920,091	968,357	85,637	16,077	-	-
Dallas	6,204,421	20,345,972	283,683	7,404,909	2,060,632	50,897	2,200	-	-
San Francisco	<u>17,013,864</u>	<u>25,815,527</u>	<u>1,522,286</u>	<u>10,281,365</u>	<u>1,357,676</u>	<u>100,869</u>	<u>29,054</u>	<u>54,963,122</u>	<u>87,456,217</u>
Totals	<u>\$154,072,910</u>	<u>\$460,024,865</u>	<u>\$41,288,447</u>	<u>\$83,970,562</u>	<u>\$16,933,584</u>	<u>\$942,172</u>	<u>\$1,822,837</u>	<u>\$94,798,648</u>	<u>\$142,301,526</u>

a/Estimated market values, or value based on tax assessments except for Boston.

b/Cost less depreciation.

c/Original cost.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

March 18, 1981

FREDERICK H. SCHULTZ
VICE CHAIRMAN

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Anderson:

Thank you for giving us the opportunity to comment on the draft of a proposed report entitled "Response to Questions Bearing on the Feasibility of Closing the Federal Reserve Banks." I understand that Board staff has communicated a few technical comments on the report to your staff.

We are in basic agreement with the conclusions stated on page 46 of the draft report and compliment the General Accounting Office on a thoughtful review of a very complex subject.

Sincerely,

A handwritten signature in black ink, appearing to read "F. H. Schultz".

Frederick H. Schultz

(233068)

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