

Annual Report: Budget Review



Board of Governors of the Federal Reserve System

1989-90

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Introduction

This report describes the budgeted expenses of the Federal Reserve System for 1990 and compares them with expenses for 1988 and 1989. Net spending for 1990 is expected to total approximately \$626 million, based on budgeted expenditures of \$1,524 million and offsetting revenues of \$898 million from priced services, reimbursements, and other operating revenues. This report also discusses a new system being introduced nationwide by the Treasury and the Federal Reserve for the sale of over-the-counter savings bonds, a system expected to save U.S. taxpayers more than \$18 million per year by 1994.

On January 11, 1990, the Board of Governors reduced the approved 1990 Federal Reserve budget by \$4.4 million to conform with the spirit of the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings). The reduction will be prorated to each Federal Reserve Bank and the Board based on the relative size and rate of increase of their respective budgets over the past three years.

The Federal Reserve System consists of the Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches, the Federal Open Market Committee, and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council.

The System was created by the Federal Reserve Act, passed by the Congress in 1913 to establish a safer and more flexible monetary and banking system. After the inception of the Federal Reserve System, it became clear that these original purposes were part of broader national eco-

nomics and financial objectives. Stability and growth of the economy, stability in the purchasing power of the dollar, and reasonable balance in transactions with foreign countries have come to be recognized as primary objectives of governmental economic policy. Over the years, such objectives have been articulated by the Congress in legislation giving the Federal Reserve more authority and responsibility.

As the nation's central bank, the Federal Reserve, through its ability to influence financial conditions, attempts to ensure growth of the economy consistent with price stability. As the nation's lender of last resort, the Federal Reserve also has the responsibility to forestall national liquidity crises.

Because a sound financial structure is essential to an effective monetary policy and a growing and prosperous economy, the Congress has entrusted the Federal Reserve with a variety of bank supervisory and regulatory functions. Among other things, the Federal Reserve administers the laws that regulate all bank holding companies; it supervises state-chartered banks that are members of the Federal Reserve System; it regulates the foreign activities of U.S. banks and the U.S. activities of foreign banks; and it establishes rules to ensure that consumers are informed adequately and treated fairly in credit transactions.

The Federal Reserve System also plays a major role in the nation's payments mechanism. Federal Reserve Banks distribute currency and coin, provide both wire and automated clearinghouse transfers of funds and securities, and process 35 percent of all domestic checks. The Federal Reserve serves as the fiscal agent

for the U.S. Treasury and provides a variety of other financial services for the Treasury and other government agencies.

To carry out these responsibilities in 1989, the Federal Reserve System spent an estimated \$1,438 million and earned an estimated \$836 million in revenue from priced services, reimbursements, and other income, for a 1989 total of \$602 million in net operating expenses. The major source of Federal Reserve income, estimated at \$20,064 million in 1989, is earnings on the portfolio of U.S. government securities in the System Open Market Account. The System uses purchases and sales from this portfolio to implement monetary policy. Gains on foreign exchange transactions approximated \$1,300 million.

Each year the Federal Reserve returns to the U.S. Treasury its earnings in excess of expenses, dividends, and surplus—in 1989, an estimated \$21,646 million. These earnings are treated as receipts in the U.S. budget accounting system; projections of these earnings by the Office of Management and Budget appear in the U.S. budget.

Part I of this report discusses Federal Reserve budgeted expenses for 1990 for the System as a whole and for the Board of Governors and the Reserve Banks taken separately. Part II describes the new delivery system for over-the-counter savings bonds. Appendixes provide additional information on System operations, budget processes, special categories of System expense, sources and uses of funds, Federal Reserve System audits, trends in Bank expenses and employment, and budget reductions in conjunction with Gramm–Rudman–Hollings.

This report, a complete discussion of the System's budget, is a companion to the Board's *76th Annual Report, 1989*. That document covers all activities and initiatives of the Federal Reserve System during the year. ■

Part I

The 1990 Budgets

Chapter 1

Federal Reserve System

For 1990, the Federal Reserve System has budgeted operating expenses of \$1,523.8 million, an increase of 6.0 percent over 1989 estimated expenses.¹ The budgeted operating expenses of the System comprise those of the Reserve Banks, \$1,419.0 million, and those of the Board of Governors, \$104.9 million (table 1.1).

Not included in these costs are special projects, budgeted at \$6.7 million for 1990, down from \$9.0 million estimated for 1989.² Also excluded is the budgeted cost of currency, \$188.7 million, an increase of 8.2 percent from the 1989 cost of \$174.4 million.³ With special projects and the cost of currency added to operating expenses, the Reserve Banks account for 82.9 percent of the total; the Board, 6.1 percent; special projects, 0.4 percent; and currency, 10.6 percent (chart 1.1). This distribution of expenses is essentially the same as in 1989.

1. The budget information presented in the text, tables, and charts does not include the cuts made in conjunction with the Balanced Budget and Emergency Deficit Control Act of 1985 (commonly known as Gramm-Rudman-Hollings). Appendix G discusses these cuts.

2. As research and development efforts, special projects are separate from the continuing operations of the System and, therefore, are not included in System operating expenses. These relatively costly, short-term projects are expected to benefit both the System and the banking industry as a whole. A description of the special projects for 1990 appears in appendix C.

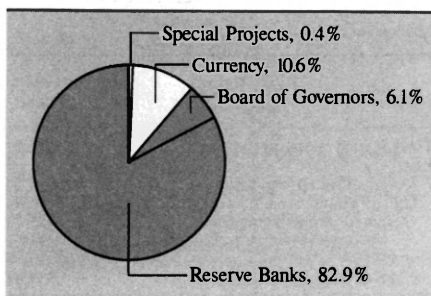
3. The Federal Reserve bears the cost associated with printing new currency at the Bureau of Engraving and Printing. Because this cost is determined largely by public demand for new currency, it is not included in Federal Reserve operating expenses. See appendix C.

Chapter 2 discusses the budget for the Board of Governors; chapter 3 details the budgets of the Reserve Banks. The budget by operational area is provided later in this chapter. Appendix A describes in more detail the operational areas; appendix B describes the budget processes of the Board and of the Reserve Banks.

Net Expenses

The System expects to recover 59 percent of the expenses it incurs during 1990. The following items are deducted from System operating expenses to derive the net cost: (1) receipts for payments mechanism services provided to depository institutions, (2) other income for services on behalf of the U.S. Treasury that are charged to depository institutions using the services, and (3) expenses that are reimbursable by the U.S. Treasury and other government agencies for fiscal agency services. After deducting these items, net expenses of the System are

Chart 1.1
Distribution of Expenses of the
Federal Reserve System, 1990¹



1. See text notes 1, 2, and 3.

expected to equal \$626.2 million, or 41 percent of total budgeted operating expenses (table 1.2).

As required by the Monetary Control Act, receipts for priced services represent fees that are set to recover the full cost of providing these services to depository institutions, including the imputed costs of float and the return on capital that would have been provided and the taxes that would have been paid had a commercial entity in the private sector furnished

the services. The revenue from priced services is detailed in table 1.3; the constraint imposed on Federal Reserve budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix C. All sources and uses of funds are presented in appendix D; the audits of the System are listed in appendix E.

The "other income" category in table 1.2 includes fees from services such as the transfer of book-entry U.S. Treasury

Table 1.1

Operating Expenses, Special Projects, and Cost of Currency of the Federal Reserve System, 1988-90¹

Millions of dollars, except as noted

Entity and type of expense	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Reserve Banks ²	1,262.4	1,341.4	1,419.0	6.3	5.8
Personnel	794.5	852.6	904.8	7.3	6.1
Nonpersonnel	467.9	488.8	514.1	4.5	5.2
Board of Governors ³	90.5	96.3	104.9	6.5	8.8
Personnel	63.8	69.7	79.4	9.2	14.0
Nonpersonnel	26.7	26.6	25.4	-.3	-4.6
System operating expenses	1,352.9	1,437.7	1,523.8	6.3	6.0
Personnel	858.8	922.3	984.2	7.4	6.7
Nonpersonnel	494.1	515.4	539.6	4.3	4.7
Special projects ⁴	4.6	9.0	6.7	...	...
Currency ⁵	165.0	174.4	188.7	5.7	8.2

1. In this and subsequent tables in this volume, details may not sum to totals and may not yield percentage changes shown because of rounding.

2. For detailed information, see chap. 3.

3. Includes expenses of the Office of Inspector General. For detailed information, see chap. 2.

4. See text note 2 and appendix C.

5. See text note 3 and appendix C.

Table 1.2

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 1988-90

Millions of dollars, except as noted

Item	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Total System operating expenses	1,352.9	1,437.7	1,523.8	6.3	6.0
LESS					
Revenue from priced services	656.8	702.4	756.5	6.9	7.7
Other income	16.4	17.0	18.0	3.7	5.9
Claims for reimbursement ¹	115.7	116.6	123.1	.8	5.5
EQUALS					
Net System operating expenses	564.0	601.7	626.2	6.7	4.1

1. The costs of fiscal agency services to the U.S. Treasury and other government agencies for which the

agencies have agreed to reimburse the Federal Reserve. In practice, not all these claims are paid.

Table 1.3

Revenue from Priced Services, 1988–90

Millions of dollars

Service	1988 actual	1989 estimate	1990 budget
Funds transfer and net settlement	69.2	76.8	79.2
Automated clearinghouse ..	42.4	48.9	52.4
Commercial check	503.7	535.1	582.5
Book-entry securities	8.7	10.2	11.1
Definitive securities	6.7	5.9	5.9
Noncash collection	11.2	11.1	11.1
Cash services	14.9	14.4	14.4
Total	656.8	702.4	756.5

securities in the secondary market, the settlement of such transfers among depository institutions, and the wire transfer of funds between a depository institution and the Treasury.

Claims for reimbursement represent the expenses incurred by Reserve Banks in providing fiscal agency services to the U.S. Treasury or to other government agencies and for which the agencies have agreed to reimburse the Federal Reserve.

Trends in Expenses and Employment

From 1980 to the level budgeted for 1990, the expenses of the System have

increased an average of 6 percent per year in current dollars and 1.5 percent when adjusted for inflation (chart 1.2). Over the same period, System employment increased a total of 185, or 0.1 percent per year (chart 1.3).

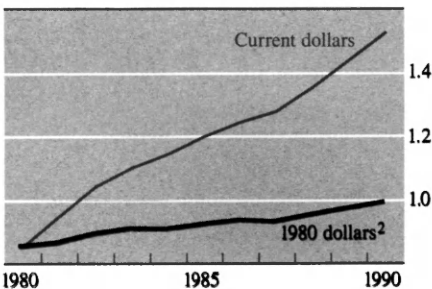
Over the past decade, the Monetary Control Act of 1980 (MCA) greatly affected System expenses and employment. It extended reserve requirements to all nonmember banks and thrift institutions, requiring the Federal Reserve to establish new systems for the collection of data and maintenance of deposit accounts. The MCA also extended access to Federal Reserve services to all depository institutions. Accordingly, System employment rose significantly during 1980 and 1981.

From 1982, when the transition to the requirements of the MCA was completed, through 1984, System expenses remained essentially flat when adjusted for inflation, and employment declined. In 1985, the Federal Reserve increased the staff in a pronounced effort to strengthen supervision and regulation of member banks and bank holding companies. The System was able to offset partially the increase in staff through reductions in employment in other areas,

Chart 1.2

Operating Expenses of the Federal Reserve System, 1980–90¹

Billions of dollars

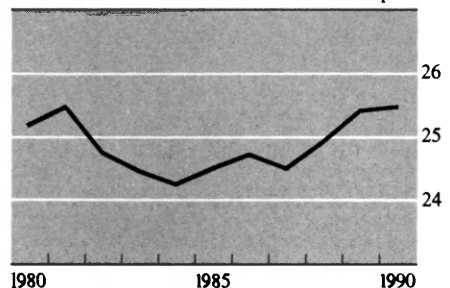


1. For 1989, estimate; for 1990, budget.
2. Calculated with the GNP price deflator.

Chart 1.3

Employment in the Federal Reserve System, 1980–90¹

Thousands of persons



1. For 1989, estimate; for 1990, budget.

primarily in services to financial institutions and the public and in support and overhead.

In 1988, the Expedited Funds Availability Act (title VI of Public Law 100-86, the Competitive Equality Banking Act of 1987) became effective. The act requires the Federal Reserve to issue regulations to ensure the prompt availability of funds and the expeditious return of checks. Increases in staff throughout the System in 1988 and 1989 resulted from implementing the provisions of this legislation.

Operational Areas

Federal Reserve expenses are classified for budgeting purposes according to the major operational areas of the System: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and services to the U.S. Treasury and other government agencies (table 1.4). Costs for

support and overhead are redistributed or allocated to these four areas. Only the Reserve Banks perform services to the Treasury and other government agencies. The operational area unique to the Board of Governors, System policy direction and oversight, is considered an overhead expense of the System (see chapter 2).

1990 Budget Initiatives

The Reserve Banks and the Board are beginning or continuing several major initiatives in 1990. Projects involving programs for the U.S. Treasury and for the Food and Nutrition Service will significantly affect the budget. On behalf of the Treasury, the System continues the nationwide expansion of the Regional Delivery System, which involves centralized issuance of over-the-counter savings bonds (chapter 4). The Food and Nutrition Service has requested changes in processing food coupons.

Table 1.4

Operating Expenses of the Federal Reserve System, by Operational Area, 1988-90¹

Millions of dollars, except as noted

Operational area and entity	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Monetary and economic policy	147.2	157.5	166.4	7.0	5.6
Reserve Banks	87.3	93.2	98.9	6.8	6.1
Board of Governors	59.9	64.3	67.5	7.3	5.0
Supervision and regulation	212.4	226.0	248.4	6.4	9.9
Reserve Banks	185.1	196.9	214.5	6.4	8.9
Board of Governors	27.4	29.1	33.9	6.2	16.7
Services to financial institutions and the public	851.7	906.5	950.4	6.4	4.8
Reserve Banks	848.5	903.5	947.0	6.5	4.8
Board of Governors	3.2	3.0	3.4	-8.0	15.0
Services to the U.S. Treasury and other government agencies ²	141.5	147.7	158.6	4.4	7.4
Total	1,352.9	1,437.7	1,523.8	6.3	6.0
Reserve Banks	1,262.4	1,341.4	1,419.0	6.3	5.8
Board of Governors ³	90.5	96.3	104.9	6.5	8.8

1. Operating expenses reflect all allocations for support and overhead and exclude capital outlays. The operational area unique to the Board of Governors, System policy direction and oversight, which is shown separately in chap. 2, has been allocated across the operational areas shown above. As a result, the numbers in chap. 2 for the

operational areas are not the same as the ones listed in this table.

2. Reserve Banks only. The Board of Governors does not provide these services.

3. Includes expenses of the Office of Inspector General.

The System will continue projects in automation related to contingency processing for critical operations, improved availability of mainframe systems, expansion of computer capacity, system conversions, and office automation initiatives.

Supervision and regulation efforts continue to receive a major emphasis in the budgets. Spending in this area will be larger than 1989 estimated expenses to accommodate the greater complexity of examinations, more holding company examinations, ongoing attention to problem institutions, and the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). The Board and the Reserve Banks are also continuing the development of the National Information Center to provide a single source for information on financial institutions needed to process applications, to monitor safety and soundness, and to maintain the accuracy of published data series.

Finally, in 1990 the Board will experience its first full year of its new compensation program. This new structure was implemented to improve the Board's ability to attract and retain a good staff that will help the Board meet its critical responsibilities. ■

Chapter 2

Board of Governors

The 1990 budget of the Board of Governors is \$103.2 million for its four operational areas and \$1.7 million for the Office of Inspector General.¹ The Board's total expenses, \$104.9 million, are 6.1 percent of the total for the Federal Reserve System. The Board authorized 1,555 positions for its operational areas in 1990, 1 fewer than in 1989 despite a significant increase in the number of positions for the supervision and regulation area and the growing workload caused by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; the Board authorized 15 positions in the Office of Inspector General (tables 2.1 and 2.2).

The 1990 budget for the Office of Inspector General (OIG) was handled and approved separately from the rest of the Board's budget this year in more formal recognition of the independence of the office. The 1988 and 1989 expenses and position complement of the OIG are shown separately in the tables to permit consistent comparisons. The 1990 budgeted expenses and staffing for the OIG, considerably higher than for the previous year, reflect an expansion in the scope and depth of coverage it gives to Board operations.

Operational Areas

For 1990 the Board of Governors has budgeted operating expenses of \$103.2 million for its four operational areas, an

increase of \$7.6 million, or 7.9 percent, over estimated expenses for 1989. The growth in Board expenses between 1989 and 1990, greater than in past years, in the main is attributable to a new compensation system and the Board's responsibilities under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). If no responsibilities are added to those carried in 1990, the 1991 budget should return to a lower growth path.

Almost one-half of the budget increase is due to the one-time adjustment in compensation in 1990, the first full year of the new employee compensation program. The adjustment, to raise salaries in certain job families judged to be below competitive levels, will not be needed in the future because annual salary surveys will be used to keep salaries close to the measured market. The program is designed to keep salaries in line with those paid by competing employers and to better attract and retain a high-quality staff.

Through FIRREA, the Congress has given new responsibilities to the Federal Reserve to help resolve the savings and loan failures and to address underlying problems of the industry. These responsibilities are the other major source of budget growth in 1990 and extend throughout much of the Board: added work will be required from the litigation and enforcement staff of the Legal Division, the financial analysis staff of the Division of Banking Supervision and Regulation, the research staff of the Division of Research and Statistics, and the accounting staff of the Office of the Controller. The act also calls on the Federal Reserve to provide staff support

1. Not reported in the text, tables, and charts of this chapter are budget reductions approved by the Board on January 11, 1990, in conjunction with Gramm-Rudman-Hollings; see appendix G.

requested by the Oversight Board of the Resolution Trust Corporation.

The 1990 budget includes continued expansion of the National Information Center. The Federal Reserve began the center in 1988, charging it to create a central, high-quality database on the structure and finances of financial institutions. Such a database would improve the ability of the System to monitor the safety and soundness of institutions, process their applications, and maintain the accuracy of published data series. The growth

of interstate banking, the acquisitions of failed financial institutions, and the growing complexity of relationships among institutions make a central data center extremely important to the System.

In mid-1989 the Board transferred responsibility for managing the Contingency Processing Center (CPC) to the Federal Reserve Bank of Richmond. The CPC, located between Washington and Richmond in Culpeper, Virginia, is the relocation facility for the Board and the backup data processing facility for the

Table 2.1

Expenses of the Board of Governors for Operational Areas and Office of Inspector General, 1988-90¹

Thousands of dollars, except as noted

Type of expense	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Monetary and economic policy	47,620	51,209	53,652	7.5	4.8
Supervision and regulation	21,743	23,142	26,935	6.4	16.4
Services to financial institutions and the public	2,574	2,373	2,722	-7.8	14.7
System policy direction and oversight	17,988	18,894	19,860	5.0	5.1
Total, operational areas	89,925	95,618	103,169	6.3	7.9
Office of Inspector General	580	730	1,684	25.9	130.7
Total	90,505	96,348	104,853	6.5	8.8

1. Operating expenses reflect all allocations for support and overhead. They exclude capital outlays. Services to the U.S. Treasury and other government agencies is an

operational area unique to the Reserve Banks and is not shown here; see chaps. 1 and 3.

Table 2.2

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1988-90

Type of expense	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Monetary and economic policy	397	398	398	.3	0
Supervision and regulation	264	267	277	1.1	3.7
Services to financial institutions and the public	22	20	20	-9.1	0
System policy direction and oversight	148	152	151	2.7	-.7
Support and overhead	734	719	709	-2.0	-1.4
Total	1,565	1,556	1,555	-.6	-.1
Office of Inspector General	8	9	15	12.5	66.7
Total	1,573	1,565	1,570	-.5	.3

System. Transferring the management function is intended to meet the expanding requirements of the Reserve Banks for backup facilities and support. The shift in use of the CPC partially offset the increase in Board expenses between 1989 and 1990; it also eliminated ten CPC positions from the Board's 1989 budget and eight positions from its 1990 budget.

The following sections analyze the operating budgets for the Board's four operational areas and Office of Inspector General and discuss trends in expenses and employment. Appendix A describes the operational areas of the Board and the Banks, appendix B discusses the Board's budgeting process, and appendix C presents, among other topics, the Board's capital outlays.

The Budget by Operational Area

The Board's activities fall into four broadly defined operational areas: monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, and System policy direction and oversight (see also chapter 1 and appendix A).

Table 2.1 shows the operating expenses, and table 2.2 shows the number of authorized positions, for each of the operational areas for each of the years 1988–90. The costs include those for support and overhead, allocated to each operational area according to that area's proportion of total direct expenses. The tables also show the expenses and employment of the Office of Inspector General for the period, which are discussed in turn.

Monetary and Economic Policy

Under its monetary and economic policy function, the Board monitors and analyzes developments in the money and

credit markets, sets reserve requirements, approves changes in the discount rate, and otherwise manages the nation's monetary policy.

This function is expected to cost \$53.7 million in 1990, an increase of \$2.4 million, or 4.8 percent, over 1989. In addition to maintaining the quality of economic analysis and forecasts, the budget includes significant funding for FIRREA, the National Information Center, and processing the data for the Survey of Consumer Finances. The growth of expenses in this operational area is held down because earlier investments in distributed processing systems have reduced the area's payment for central automation services. Also, 1989 expenses for the Survey of Consumer Finances will not recur.

FIRREA will require substantial resources from the monetary and economic policy area on issues relating to deposit insurance, for monitoring the savings and loan industry, and for support to the Oversight Board of the Resolution Trust Corporation.

The staff made progress in 1988 and 1989 to define the requirements of the National Information Center, discussed above, and to assemble information. The 1990 budget supports further efforts in this important area.

The Survey of Consumer Finances is a major update of data, last obtained in 1983, on the income, assets, debts, pensions, and employment for U.S. households and their use of financial services. The 1990 costs for analyzing the survey data are less than the 1989 cost of gathering the data.

Supervision and Regulation

Supervision of financial institutions includes reviews of examination and inspection reports on state member banks prepared by the Reserve Banks, special

studies related to international applications, direction of enforcement actions, and regulation of trust activities. Regulation includes the formulation of regulations; the oversight of mergers, foreign banking activities, and compliance with consumer regulations; and the regulation of securities credit.

The \$26.9 million budget for supervision and regulation is \$3.8 million, or 16.4 percent, greater than estimated expenses for 1989. The new compensation program, discussed above, had a heavy effect on the costs of this operational area because of its large concentration of financial analysts and attorneys, job families whose salaries are rising more rapidly than at other areas of the Board. The ten positions added in this area are related to FIRREA and underlying problems in the financial industry. Reductions in the staffing of Boardwide support and overhead functions prevented a net increase in the number of positions at the Board. Additional resources may still be required in 1990 to meet the full requirements of FIRREA and the situation in the financial industry.

Improvements in the information systems for supervision and regulation include work on the National Information Center, replacement of the various office automation systems in the Legal Division with a single system, and the installation of more and faster microcomputers and a local area network in the Division of Banking Supervision and Regulation.

Services to Financial Institutions and the Public

The \$2.7 million budgeted for services to financial institutions and the public is \$349,000, or 14.7 percent, higher than 1989 estimated expenses. This operational area is composed almost entirely of the System's payments function. The

1990 budget includes funds to meet growing travel requirements and training expenses of the staff and to support the automation of currency operations. The automation project, begun in 1988, has produced major savings in the System's currency expenses by minimizing the number of shipments and reducing the overall volume of currency needed.

The payments risk program, established in mid-1989, is a major source of added costs this year, in part because 1990 is its first full year of operation. The program coordinates the analysis of risks associated with national and international payment and settlement systems.

System Policy Direction and Oversight

The \$19.9 million budget for System policy direction and oversight is \$1.0 million, or 5.1 percent, more than estimated 1989 expenses. With no major increases in responsibilities, no increase in staffing, no automation initiatives, and no major salary adjustments required by the new compensation system, this area shows a cost increase for 1990 that is below the Boardwide average. The comparison with last year excludes the budget for the OIG, which formerly was part of this area and is now approved and displayed separately.

Ten-Year Trend

Operating expenses for the Board's four operational areas have grown from \$59.8 million in 1980 to \$103.2 million budgeted for 1990, an average increase of 5.6 percent per year in current dollars and 1.5 percent per year in 1980 dollars (chart 2.1). During this period, the costs for personnel have increased at an annual average of 5.3 percent in current dollars and 1.1 percent in 1980 dollars (chart 2.2); and expenses for goods and ser-

vices have risen an annual average of 6.8 percent in current dollars and 2.6 percent in 1980 dollars (chart 2.3). The markedly faster pace for goods and services relative to personnel reflects the substantial investment in automation during the period and successful efforts to limit the number of positions at the Board.

The size of the current-dollar increases in expenses has varied greatly from year to year (chart 2.4): periods of major

growth in the workload required additional resources, which were then scaled back as the new work was assimilated, productivity-enhancing technology was acquired, and lower-priority tasks discontinued. This variation is demonstrated by the changes in staffing during the ten-year period (chart 2.5).

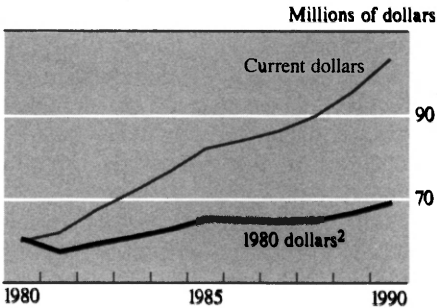
The following discussion breaks the ten-year period into three segments: 1980–85 when resources, particularly for data collection and storage, were added to meet the requirements of major legislation; 1986–88, when adjustments by the Board reduced the number of positions added during the previous period; and 1989–90, when the year-to-year decreases associated with the position reductions of the earlier period ended, and the costs of the new compensation program began.

1980–85

Expenses rose sharply between 1980 and 1985, although a reduction in 1981 of \$3.7 million for retiree cost-of-living adjustments negated a portion of the increase. Federal pay increases during

Chart 2.1

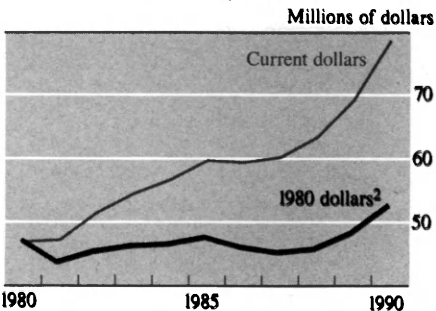
Operating Expenses of the Board of Governors, 1980–90¹



1. Excludes the Office of Inspector General. For 1989, estimate; for 1990, budget
2. Calculated with the GNP price deflator.

Chart 2.2

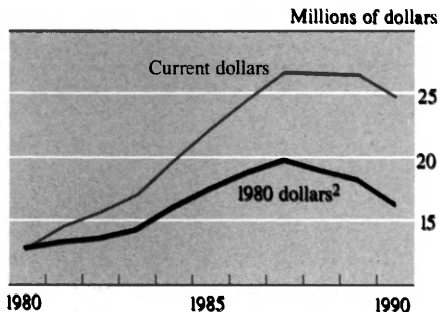
Expenses for Personnel Services at the Board of Governors, 1980–90¹



1. Excludes the Office of Inspector General. For 1989, estimate; for 1990, budget.
2. Calculated with the GNP price deflator.

Chart 2.3

Expenses for Goods and Services at the Board of Governors, 1980–90¹



1. Excludes the Office of Inspector General. For 1989, estimate; for 1990, budget.
2. Calculated with the GNP price deflator.

these years, although markedly below those in the private sector, were high compared with the federal increases approved later in the decade. More significant, however, were the costs of resources added to meet the requirements of new legislation. The average annual increase in expenses for this period, 1.7 percent in 1980 dollars, derived mainly from the Monetary Control Act (MCA).

Under the MCA, the number of institutions directly or indirectly reporting financial data to the Federal Reserve tripled, from about 14,000 to about 45,000, and the number of items all institutions were required to report grew substantially. This surge in the volume of work handled at the Federal Reserve required a new mainframe computer and large additions to the staff for data processing and for monetary policy. The requirement of the MCA that the Federal Reserve price many services it had previously provided without explicit charge and expand their availability also imposed start-up costs. Deregulation and other changes in the banking industry arising from the Financial Institutions Regulatory and Interest Rate Control Act

required additional supervisory staff. To meet all of these requirements the number of positions grew from 1,575 in 1980 to 1,653 in 1984, an increase of almost 5 percent. Employment grew a like percentage, from 1,516 to 1,588. Although the number of positions and employees began a substantial decline in 1985 (see the discussion of the Program Improvement Project in the next section), expenses did not begin to reflect the change until 1986.

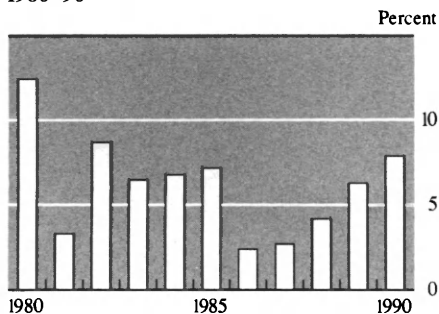
1986-88

In mid-1984 the Board established the Program Improvement Project (PIP) to reduce the number of positions at the Board 7 percent by the end of 1986. PIP substantially reduced, and changed the structure of, the data processing divisions; it produced somewhat smaller reductions in the rest of the Board's divisions.

Although the project carefully considered the exemption of areas addressing problems such as the trade deficit and the debt positions of developing countries, it excluded only the supervision and regulation area from reductions. After six

Chart 2.4

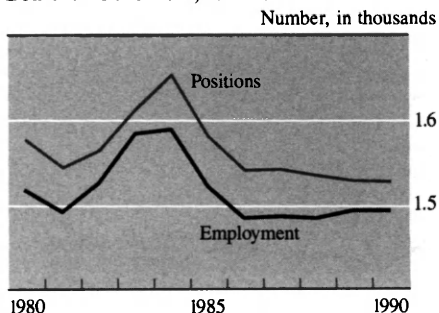
Annual Rate of Change in Operating Expenses of the Board of Governors, 1980-90¹



1. Excludes the Office of Inspector General. For 1989, estimate; for 1990, budget.

Chart 2.5

Employment and Positions at the Board of Governors, 1980-90¹



1. Year-end data. Excludes summer intern and youth positions and the Office of Inspector General. For 1989, estimate; for 1990, budget.

positions supporting lower-priority functions in the supervision and regulation area were abolished, twenty-nine positions were added to the programs in the area directly concerned with the growing number of problems in the nation's banking industry. Even with this increase, the net number of positions Boardwide declined by seventy-three in 1985.

The one-time costs of implementing PIP, coupled with the intensified automation of critical functions, moderated the 1985 savings from lower salary costs. PIP yielded a further decrease of forty positions in 1986. The effect of these reductions was clearly evident in the changes in total operating expenses from 1985 to 1986 and from 1986 to 1987, which in current dollars averaged 2.6 percent per year; from 1987 to 1988, expenses in current dollars rose a more normal 4.2 percent. In 1980 dollars, expenses on average declined 0.1 percent per year between 1985 and 1988.

1989–90

With the costs of new legislative demands, a major survey of consumer finances, and the increases in salary expense tied to the first phase of the new compensation program, expenses in 1989 rose 6.3 percent in current dollars and 2.8 percent in 1980 dollars.

In 1990 the path turned further upward with the full implementation of the compensation program, the full-year effect of added legislative requirements associated with FIRREA, and continued pressures in the supervision function. Although the Board authorized ten new positions in the area of supervision and regulation, reductions in overhead and support have kept the number of positions at the Board slightly below the level in 1989. Pressure in other areas, such as programs dealing with financial markets, has been met through overtime and reduction in the

level of long-term research that is funded within the budget.

Office of Inspector General

The Board created the Office of Inspector General in July 1987. The reporting relationships, duties, and responsibilities of the OIG were formalized by the Inspector General Act Amendments of 1988.

The 1990 operating budget for the OIG is \$1.7 million, \$1.0 million more than estimated 1989 expenses. The 131 percent increase reflects the adjustment of a fairly new organization, the additional responsibilities related to the Inspector General Act Amendments, and the cost of rented office space acquired for the OIG beginning in 1990. The higher level of funding will provide broader and deeper audits and investigations of the Board's operating areas and expanded reviews of new and existing laws and regulations for their effect on the operations and expenses of the Board.

The net increase in the number of OIG positions is six—three auditors, a new investigator, an administrative assistant, and a secretary—and brings the total to fifteen.

The \$1.0 million increase in operating costs includes the rise in the number of positions (\$0.4 million), normal increases in the costs of salary and fringe benefits (\$0.1 million), and \$196,000 for office space, utilities, and other services.² It also includes \$167,000 for additional travel for a higher volume of visits to Reserve Banks, for reimbursement to the Reserve Banks for travel costs of staff performing operations reviews, and for the transportation required for staff train-

2. Office space, utilities, and other services are charged to the OIG function in parallel to the allocation of support and overhead to the operational areas.

ing. A higher volume of data processing support, necessary to track projects and analyze data, will add \$71,000 to OIG expenses, while the acquisition of office automation equipment, in part to support new staff, will add \$33,000. ■

Chapter 3

Federal Reserve Banks

The 1990 operating budget approved by the Board of Governors for the Federal Reserve Banks is \$1,419.0 million, an increase of \$77.6 million, or 5.8 percent, over 1989 estimated expenses.¹ The operating budget of the Reserve Banks excludes the costs of Systemwide special research and development projects, of which three are to be pursued in 1990 (see appendix C): digital imaging of checks (\$1.6 million), currency authentication systems (\$3.2 million), and the electronic payments processor (\$1.9 million). Including the costs of these special projects, which are declining, the System's 1990 budget is \$1,425.7 million, an increase of \$75.3 million, or 5.6 percent, over 1989 estimated expenses (table 3.1).

A major factor in the 1990 budget increase is health care costs, projected for 1990 to rise \$6.8 million, or 14.2 percent, over the estimated health care costs for 1989. This increment alone is an increase of 0.5 percent in total 1989 estimated expenses.

Employment excluding the staff associated with the special projects is budgeted at 23,890 average number of personnel (ANP), an increase of 47, or 0.2 percent, over estimated 1989 employment.² Including the special

projects, total budgeted employment is 23,913, an increase of 38, or 0.2 percent, over 1989 (table 3.1).

Expenses for personnel, which consist of salaries and benefits, account for \$904.8 million, or 64 percent, of Reserve Bank expenses in 1990, an increase of \$52.2 million, or 6.1 percent, over 1989. Nonpersonnel expenses are budgeted at \$514.1 million, an increase of \$25.4 million, or 5.2 percent. These expenses are influenced primarily by automation and building projects (table 3.2).

The following two sections discuss the major initiatives and the budget objective for the Reserve Banks in 1990. Subsequent sections provide details for the four operational areas as well as objects of expense, capital outlays, and long-term trends. Appendix C gives details on capital outlays, special projects, and other special categories of expense. Appendix F gives further data by District and by operational area.

Major Initiatives

The 1990 increase in total expenses includes \$30.6 million in Reserve Bank initiatives (table 3.3):

- Enhanced facilities at head offices and Branch buildings
- Enhancement of fiscal agency services for the U.S. Treasury and the U.S. Department of Agriculture's Food and Nutrition Service
- Improved automation services

1. Not reported in this chapter are budget reductions approved by the Board on January 11, 1990, in conjunction with Gramm-Rudman-Holings; see appendix G.

2. The term average number of personnel describes levels and changes in employment at the Reserve Banks. ANP measures the number of employees in terms of full-time positions for the time period. For instance, a full-time employee who starts work July 1 counts as 0.5 ANP for that

year; two half-time employees who start January 1 count as one ANP. The ANP for any given year is the average of the number of full time employees (measured in this way) in the months of that year.

- Increased supervisory examinations and inspections of banks and bank holding companies
- Enhanced check and cash operations.

Improvements in facilities throughout the System continue to increase operating expenses. The 1990 increase of \$4.9 million for such improvements primarily arise from the increased operating expenses of the new Charlotte building and the renovated Chicago building.

The \$5.7 million increase for fiscal agency services primarily reflects the enhanced services for the U.S. Treasury and the Food and Nutrition Service. The more significant expense, \$4.1 million, is for the nationwide expansion of the Regional Delivery System, which consol-

idates issuance of over-the-counter savings bonds (see chapter 4). System-wide implementation of the project, which began as a pilot program at the Federal Reserve Bank of Cleveland, will continue through 1993. A staff increase of 116 ANP is expected in 1990 and a total staff increase of 350 ANP is projected by the time the project is fully implemented. Although this initiative results in additional short-term expenses for the Federal Reserve Banks, the costs are more than offset by savings at government agencies and commercial banks.

The second fiscal agency initiative is nationwide implementation of changes requested by the Food and Nutrition Service in processing food coupons. These changes, first tested at the Memphis and Dallas offices, will add \$0.6

Table 3.1

Expenses and Employment at the Federal Reserve Banks, 1989-90¹

Category	1989 estimate	1990 budget	Change	
			Amount	Percent
<i>Expenses (millions of dollars)</i>				
Operations ²	1,341.4	1,419.0	77.6	5.8
Special projects	9.0	6.7	2.3	25.0
Total	1,350.4	1,425.7	75.3	5.6
<i>Employment (average number of personnel)³</i>				
Operations ²	23,843	23,890	47	.2
Special projects	32	23	9	28.1
Total	23,875	23,913	38	.2

1. Excludes capital outlays. In this and the following tables, the 1990 budget does not include reductions made in conjunction with Gramm-Rudman-Hollings; see appendix G.

2. Including support and overhead (see appendix F, table F.3, note 1 for definition).

3. See text note 2 for definition of average number of personnel.

Table 3.2

Operating Expenses of the Federal Reserve Banks, by Object, 1988-90¹

Thousands of dollars, except as noted

Object	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Personnel	794,506	852,591	904,823	7.3	6.1
Nonpersonnel	467,873	488,797	514,149	4.5	5.2
Total	1,262,378	1,341,388	1,418,972	6.3	5.8

1. Including the costs of support and overhead (see appendix F, table F.3, note 1 for definition).

million and increase staff 22 ANP in 1990. Expenses for the savings bond and food coupon initiatives are fully reimbursable.

Expenses for automation projects to improve contingency back-up systems and reduce down-time will continue in 1990 at a cost of \$4.1 million. Of this, \$1.5 million will cover the increase in the Reserve Banks' share of operating expenses for the Contingency Processing Center (CPC). The \$8.4 million in other automation efforts covers expansion of computer capacity in several Districts; development of a new automated clearinghouse system; a rewrite of the book entry system; continuation of San Francisco's conversion to a new operating system; and office automation initiatives at several Districts.

The increase for supervision and regulation is primarily for additional staff members to handle the greater complexity and volume of examinations and the ongoing attention to problem institutions. Related expenses such as travel will also contribute to the increase in this area.

Table 3.3
Operating Expenses Budgeted
for Major Initiatives of the Federal
Reserve Banks in 1990

Area of initiative	Millions of dollars	Percent of 1990 operating budget
Facilities	4.9	.4
Fiscal activities	5.7	.4
Contingency back-up	4.1	.3
Automation	8.4	.6
Supervision and regulation	1.5	.1
Check operations	4.3	.3
Currency processing	1.7	.1
Total	30.6	2.2
MEMO		
Increase in total operating expenses, 1989 estimate to 1990 budget	77.6	5.8

Six Districts are upgrading existing check systems at an estimated cost of \$4.3 million. In addition, New York and San Francisco will be automating their check adjustment processes.

The cost of developing a new generation of high-speed currency sorters, designed to improve labor productivity, is budgeted for 1990 at \$1.7 million.

1990 Budget Objective

Earlier this year, the Board approved a 1990 objective for Reserve Bank budgets, including special projects, that targeted the overall increase over 1989 expenses at 6.0 percent. The budget objective for operating expenses, which exclude special projects, targeted an increase of \$81.8 million, or 6.1 percent, over 1989 estimated expenses. The 1990 budget objective did not include funds for developing the daylight overdraft pricing system or for the Reserve Banks to absorb more of the operating expense of the CPC.

The 1990 budget compares favorably with the budget objective. Total operating expenses are increasing \$77.6 million, or 5.8 percent. (table 3.4). In addition, the expenses associated with the special projects are decreasing \$0.8 million more than originally projected. Overall, the 1990 budget increase is \$5 million less than projected when the Board approved the budget objective, despite \$2 million in unanticipated extra expense in 1990 for the daylight overdraft pricing system and the CPC.

Operational Areas

Tables 3.5 and 3.6 summarize Reserve Bank expenses and employment in each of the four operational areas. Tables 3.7 through 3.10 show expense details for each area.

Monetary and Economic Policy

Expenses in 1990 for the conduct of monetary and economic policy at the Federal Reserve Banks total \$98.9 million and account for 7.0 percent of their budgets. The increase of \$5.7 million, or 6.1 percent, from estimated 1989 expenses reflects staff increases, salary administration actions, and additional equipment and data processing costs associated with automation initiatives. Employment at 786 ANP is an increase of 8 ANP over estimated 1989 levels. The 1989 employment estimate is below the approved budget because of the Banks' inability to fill all positions authorized for 1989, the number of which is the same for the 1990 budget.

Automation initiatives, all at the New York Bank, include improvements to the flow of market data for foreign exchange and open market operations; increased equipment depreciation and maintenance costs for the securities trading and clearing system, the information display system, and the office and analytical support system (OSS); the development of a new foreign exchange accounting system; and the implementation of OSS for the open market and statistics function.

Supervision and Regulation

Expenses for supervision and regulation, budgeted at \$214.5 million for 1990, are

Table 3.4

Comparison of 1990 Budget Objective and Budget of the Reserve Banks with 1989 Estimated Expenses¹

Change, percent

Item	1990 budget objective	1990 budget
Operating expenses	6.1	5.8
Special projects	-.1	-.2
Total	6.0	5.6

1. See data on expenses in table 3.1.

expected to increase \$17.6 million, or 8.9 percent, over the 1989 estimate. This operational area now constitutes 15.1 percent of total System expenses, compared with 13.6 percent in 1985. The budgeted staff level is 2,258 ANP, an increase of 36 ANP, or 1.6 percent, over 1989.

The expense increase is centered on the addition of 36 ANP and increases in compensation, travel, training, and automation. Most Districts project an increase in the number and complexity of examinations in 1990. Also, the number of supervised institutions is increasing in some Districts. Examinations deferred during 1989 because of the reallocation of resources to assist other agencies with the savings and loan crisis will be rescheduled for 1990. The remaining staff increases are in Boston, Minneapolis, and Dallas, each of which has identified a major initiative in this area. Another factor contributing to the expense increase is the program on daylight overdraft pricing.

Services to Financial Institutions and the Public

Expenses for services to financial institutions and the public, which include both priced and nonpriced services, are budgeted at \$947.0 million and account for two-thirds of total expenses. Expenses are increasing \$43.4 million, or 4.8 percent, over the 1989 estimate. Staffing is budgeted at 9,335 ANP, down 160 ANP, or 1.7 percent, primarily because of reductions of 18 ANP in currency, 105 ANP in commercial check, and 24 ANP in services rendered others. The reduction in services rendered others is associated with an anticipated reduction in staff assistance provided to other agencies to address problems in the savings and loan industry. Expenses of priced services are budgeted at \$622.1 million, an increase

of 4.5 percent. Expenses of the nonpriced services are budgeted to increase 5.5 percent.

Commercial check processing is by far the largest service (\$477.8 million), comprising half the budgeted expenses of this operational area and employing 5,814 ANP. The anticipated increase in expenses is \$19.9 million, or 4.3 percent, over estimated 1989 levels. (Estimated 1989 expenses are \$17.7 million, or 4.0 percent, above the approved 1989 budget because of unanticipated expenses associated with the implementation of the Expedited Funds Availability Act.) Staffing levels for 1990 include a reduction of 105 ANP resulting from the stabilization

of workloads in the commercial check, check adjustment, and check return item areas. Commercial check volume is budgeted to increase 1.5 percent; the volume of return items is expected to be stable during 1990.

Expenses for the currency service are expected to increase \$9.3 million, or 7.4 percent. The net staffing levels will decrease 18 ANP primarily because of a reduction of 11 ANP in Boston resulting from a change from dual control to limited joint control and a reduction of 12 ANP in New York related to a shift from medium-speed to high-speed currency processing. Volume will continue to increase in the currency areas. Other

Table 3.5

Operating Expenses of the Federal Reserve Banks, by Operational Area, 1988-90

Thousands of dollars, except as noted

Operational area	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Monetary and economic policy	87,283	93,198	98,874	6.8	6.1
Supervision and regulation	185,090	196,914	214,478	6.4	8.9
Services to financial institutions and the public	848,481	903,546	946,973	6.5	4.8
Services to the U.S. Treasury and other government agencies	141,524	147,729	158,647	4.4	7.4
Total	1,262,378	1,341,388	1,418,971	6.3	5.8

Table 3.6

Employment at the Federal Reserve Banks, by Activity, 1988-90

Average number of personnel, except as noted¹

Activity	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
<i>Operational areas</i>					
Monetary and economic policy	766	778	786	1.6	1.0
Supervision and regulation	2,209	2,222	2,258	.6	1.6
Services to financial institutions and the public	9,033	9,495	9,335	5.1	-1.7
Services to the U.S. Treasury and other government agencies	1,819	1,787	1,890	-1.7	5.7
<i>Support and overhead²</i>					
Support	4,562	4,597	4,636	.8	.8
Overhead	4,951	4,962	4,985	.2	.5
Total	23,337	23,843	23,890	2.2	.2

1. See text note 2 for definition of average number of personnel.

2. See appendix F, table F.3, note 1 for definitions.

initiatives affecting this service are automation efforts in various Districts and the project to develop a second generation of high-speed currency processing equipment.

Expenses for the automated clearing-house (ACH) service are budgeted to increase \$4.0 million, or 5.3 percent, and its staffing level is expected to decrease 3 ANP. There is a shift in expense growth from government ACH to commercial ACH that corresponds to the faster growth of the latter. Total ACH volume is projected to increase 14 percent in 1990. The major initiative affecting this service is Fedline II, which is the standard intelligent-terminal software for access to Federal Reserve services.

Expenses associated with public programs are budgeted to increase \$2.9 million, or 6.8 percent. Staff levels will increase 6 ANP. The increases result from a greater involvement in regional

and public forums, provision of outreach programs, and additional efforts in the automation of mailing and subscription lists.

Services to the U.S. Treasury and Other Government Agencies

Expenses for services to the U.S. Treasury and other government agencies are budgeted at \$158.6 million, an increase of \$10.9 million, or 7.4 percent, from estimated expenses for 1989, and represent approximately 11 percent of the Reserve Banks total operating costs. Staffing levels are budgeted to increase 103 ANP, or 5.7 percent. The major initiatives driving the increases in both expenses and staff levels are the nationwide expansion of the Regional Delivery System, which consolidates issuance of over-the-counter savings bonds at one office within each District, and the nation-

Table 3.7

Expenses of the Federal Reserve Banks for Monetary and Economic Policy, 1988-90

Thousands of dollars, except as noted

Service	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Economic policy determination.....	73,230	75,469	79,993	3.1	6.0
Open market trading.....	14,052	17,729	18,881	26.2	6.5
Total.....	87,283	93,198	98,874	6.8	6.1

Table 3.8

Expenses of the Federal Reserve Banks for Supervision and Regulation, 1988-90

Thousands of dollars, except as noted

Service	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Supervision of District financial institutions.....	111,069	119,858	130,955	7.9	9.3
Administration of laws and regulations related to banking.....	65,634	66,664	72,138	1.6	8.2
Studies of banking and financial market structures.....	8,388	10,392	11,385	23.9	9.6
Total.....	185,090	196,914	214,477	6.4	8.9

wide expansion of changes in the requirements for processing food coupons.

By the end of 1993, the Regional Delivery System is scheduled to replace the existing network of issuing agents. Under the system, applications for savings bonds are accepted at various financial institutions and forwarded to the Federal Reserve, where the inscription data for the bond are entered into a computer data base, transmittals are balanced, accounting entries made, and the bonds are printed and mailed to the customers. During 1990 the program

will expand to cover all or parts of eight Districts (see chapter 4).

The changes in the processing of food coupons requested by the Food and Nutrition Service of the U.S. Department of Agriculture, requires Federal Reserve Banks to verify that the value of redemption certificates and the value of food coupons match in each deposit. Financial institutions are also required to encode the redemption certificates to allow their processing on check equipment and the transmittal of the data to the Minneapolis data center of the Food and Nutrition

Table 3.9

Expenses of the Federal Reserve Banks for Services to Financial Institutions and the Public, 1988-90

Thousands of dollars, except as noted

Service	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Currency and coin	142,405	148,807	159,712	4.5	7.3
Special cash	14,101	13,669	13,383	-3.1	-2.1
Commercial checks	428,773	457,874	477,793	6.8	4.4
Other checks	17,087	20,612	21,746	20.6	5.5
Funds transfers	61,054	63,773	65,824	4.5	3.2
Automated clearinghouse	67,840	74,180	78,149	9.3	5.4
Book-entry securities transfers	25,813	28,912	31,318	12.0	8.3
Definitive securities safekeeping and noncash collection	16,742	15,654	15,956	-6.5	1.9
Loans to members and others	14,136	15,202	15,594	7.5	2.6
Public programs	40,350	43,250	46,179	7.2	6.8
Other	20,180	21,613	21,320	7.1	-1.4
Total	848,481	903,546	946,973	6.5	4.8

Table 3.10

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies, 1988-90

Thousands of dollars, except as noted

Service	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Savings bonds	40,700	41,191	40,999	1.2	-.5
Central operations, savings bonds .....	...	4,959	11,302	...	127.9
Other Treasury issues	16,589	16,943	17,304	2.1	2.1
Central operations, other Treasury issues .....	...	1,461	1,545	...	5.7
Central Treasury and agency services	25,970	22,823	23,413	-12.1	2.6
Government accounts	20,038	22,069	23,523	10.1	6.6
Food coupons	13,054	13,376	14,888	2.5	11.3
Other	25,177	24,906	25,673	-1.1	3.1
Total	141,524	147,730	158,647	4.4	7.4

Services via FRCS-80, the Federal Reserve's data communications system. These procedures were successfully tested in the Dallas and Memphis territories for the six months ending March 1989.

Objects of Expense

Operating expenses for personnel comprise officer and employee salaries, other compensation to personnel, and retirement and other benefits. Total personnel costs account for 63.8 percent of Reserve Bank expenses and are expected to increase 6.1 percent in 1990 (table 3.11).

Salaries and other personnel expenses account for nearly 52 percent of 1990 budgeted expenses and are expected to be

\$35.4 million, or 5.0 percent, above estimated 1989 expenses. Salaries are budgeted to increase \$38.3 million, or 5.6 percent, and will be partially offset by a decline in other personnel expenses of \$2.9 million, or 22.5 percent. The decrease in other personnel expenses results from a declining use of personnel agencies. Merit pay increases of \$34.7 million, or 5.0 percent, are the primary reason for salary expense growth. Also contributing to additional salary expenses are promotions, reclassifications, structure adjustments, and staffing level increases. These increases are partially offset by short-term position vacancies and reduced overtime.

Expenses for retirement and other benefits, which account for 11.8 percent

Table 3.11

Operating Expenses of the Federal Reserve Banks, by Object, 1988-90

Thousands of dollars, except as noted

Object	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
PERSONNEL					
Officers' salaries	64,044	67,707	72,561	5.7	7.2
Employees' salaries	581,888	621,451	654,928	6.8	5.4
Other personnel ¹	15,349	13,057	10,116	-14.6	-22.5
Retirement and benefits	133,224	150,377	167,219	12.9	11.2
Total personnel	794,506	852,591	904,823	7.3	6.1
NONPERSONNEL					
Forms and supplies	51,049	53,215	54,812	4.2	3.0
Equipment	153,809	159,848	172,638	3.9	8.0
Software .....	..	25,944	28,826	..	11.1
Shipping	81,969	82,821	84,540	1.0	2.1
Travel	25,263	27,165	28,182	7.5	3.7
Buildings					
Insurance	750	674	718	-10.1	6.5
Taxes on Real Estate	23,983	25,082	28,770	4.6	14.7
Property Depreciation	28,408	30,923	34,993	8.9	13.2
Utilities	22,981	24,337	26,128	5.9	7.4
Rent	21,682	21,150	22,062	-2.5	4.3
Other	18,073	18,767	18,460	3.8	-1.6
Total buildings	115,877	120,932	131,129	4.4	8.4
Recoveries	-34,276	-35,058	-37,527	2.3	7.0
All other ²	74,184	53,930	51,548	-27.3	-4.4
Total nonpersonnel	467,873	488,797	514,149	4.5	5.2
Total	1,262,378	1,341,388	1,418,972	6.3	5.8

1. Expenses for certain contractual arrangements, and miscellaneous personnel expenses.

2. Communications, fees, other, contra-expenses,

shared costs received, support cost distributed, support cost received, and other.

of Reserve Bank budgets, are anticipated to increase \$16.8 million, or 11.2 percent, in 1990. This increase is the result of continued escalation in hospital and medical costs and a rise in the social security tax.

Nonpersonnel expenses account for 36.2 percent of Reserve Bank expenses and are projected to increase 5.2 percent in 1990. Equipment expenses are expected to increase 8.0 percent and to account for 12.2 percent of total costs in 1990. Most of the increase is for depreciation, reflecting acquisitions to expand data processing and data communications because of increased workloads and the full-year effect of equipment purchased in 1989.

Software expenses are projected to increase \$2.9 million, or 11.1 percent, in 1990 as the result of purchases for mainframes and personal computers and of higher rates for licenses and maintenance fees.

Shipping costs account for 6.0 percent of the 1990 budget and are projected to increase 2.1 percent in 1990. The increase is primarily the result of rate increases by contract carriers and carriers supporting the InterDistrict Transportation System. Partially offsetting the 1990 increase is the reduction in postage

expense due to a lower projected volume in the fiscal area.

Building expenses, which account for 9.2 percent of total expenses, are expected to increase 8.4 percent in 1990. The newly renovated Chicago office, the Atlanta addition and renovation, and the full-year effects of the Charlotte Branch contribute to higher costs for property depreciation and utilities. These projects, along with the Dallas building project, are expected to increase real estate taxes \$3.7 million, or 14.7 percent. The \$0.3 million decline in other building expenses is the result of the completion of renovations at the New York Bank.

Recoveries are expected to increase \$2.5 million, or 7.0 percent, in 1990, primarily because of new leases with outside organizations in the New York and Chicago offices.

Other nonpersonnel expenses are projected to decrease \$2.4 million, or 4.4 percent, mainly because consulting contracts on building facilities at several Reserve Banks have been completed.

Capital Outlays

Capital Outlays are budgeted at \$274.9 million, an increase of \$57.2 million, or 26.3 percent, above the 1989 estimate

Table 3.12

Capital Outlays of the Federal Reserve Banks, by Class of Outlay, 1988-90

Thousands of dollars, except as noted

Class of outlay	1988 actual	1989 estimate	1990 budget	Percent change	
				1988-89	1989-90
Data processing and data communications equipment	78,048	70,842	133,150	-9.2	88.0
Furniture, furnishings and fixtures	11,684	14,079	15,895	10.5	12.9
Other equipment	12,050	16,196	24,964	34.4	54.1
Land and other real estate	368	55,218	5,126	...	-90.7
Buildings	55,165	48,365	80,368	-12.3	66.2
Building machinery and equipment	7,574	11,172	14,229	47.5	27.4
Leasehold improvements	2,256	1,884	1,210	-16.5	-35.8
Total	167,144	217,756	274,940	30.3	26.3

(table 3.12). The capital budgets continue to be dominated by outlays for data processing and data communications equipment and for buildings.

Outlays for data processing and data communications equipment are \$133.1 million in 1990 and constitute approximately 48 percent of total capital outlays. The major expenses in this category are for new mainframes and computer upgrades (\$39.0 million), controllers (\$5.8 million), and check equipment (\$35.9 million).

Building outlays total \$80.4 million, or about 29.2 percent of total outlays; most of the expense is for additions and improvements. Purchases of furniture and other equipment are budgeted at \$40.9 million, much of it for relocation and extensive refurbishing in five Districts. In addition, outlays for new automated currency processing equipment are included for nine Districts at a total cost of \$4.6 million. Outlays for building machinery and equipment are budgeted at \$14.2 million.

Purchases of land and other real estate in 1990 are set at \$5.1 million, primarily for land for the Cleveland building project. Leasehold improvements total \$1.2 million, mainly for tenant improvements in the Philadelphia District (\$0.4 million) and the Chicago District (\$0.5 million).

Trends in Expenses and Employment

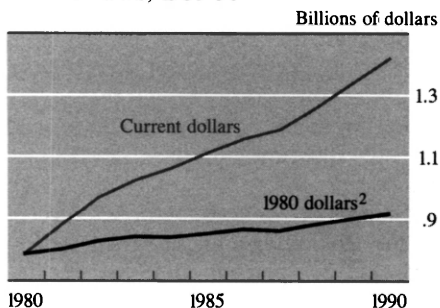
For the ten years ending in 1990, operating expenses of the Reserve Banks in current dollars will have increased an average of 6.0 percent per year (chart 3.1). Increases were larger during the early 1980s, when the Banks began implementing the requirements of the Monetary Control Act (MCA). During the period 1980 to 1983, expenses increased an average of 9.1 percent per

year. The more recent period, 1984 to 1990, shows a much lower trend, with expenses rising an average of 4.9 percent per year. Figured in 1980 dollars, the annual rate of growth over the ten-year period averaged 1.5 percent.

Over the last decade the number of employees at the Reserve Banks has increased 231 ANP, or 0.1 percent per year (chart 3.2). Employment at the Reserve Banks peaked at 26,567 ANP in 1974; it then declined a total of 3,624 ANP, or 13.6 percent, during the next

Chart 3.1

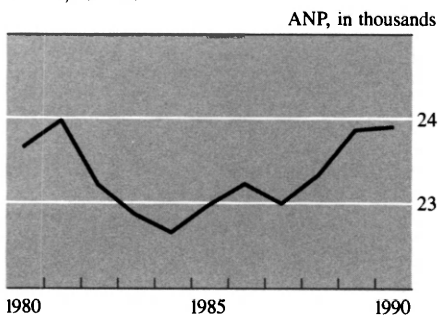
Operating Expenses of the Federal Reserve Banks, 1980-90¹



1. For 1989, estimate; for 1990, budget.
2. Calculated with the GNP price deflator.

Chart 3.2

Employment at the Federal Reserve Banks, 1980-90¹



1. For 1989, estimate; for 1990, budget. See text note 2 for definition of ANP.

five years under a Systemwide program to increase productivity. Employment increased in 1980 and 1981 because of the MCA. Over the next three years, however, employment declined a total of 1,320 ANP, or 5.5 percent, to reach a level of 22,669 ANP in 1984, the lowest level in the 1980-90 period. Employment in 1987 declined 229 ANP in part because of budget restraint in the spirit of the Gramm-Rudman-Hollings legislation. Employment increased 335 ANP in 1988 and is estimated to have increased 494 ANP in 1989 primarily as a result of implementing the provisions of the Expedited Funds Availability Act. In 1990, employment is budgeted to increase 47 ANP.

Volume and Unit Cost

Volume for all measured operations in 1990 is expected to increase 3.0 percent over 1989, while unit costs are expected to rise 1.8 percent in current dollars (table 3.13). Over the five years from

1985 to 1990, the average annual growth rate will thus be 3.8 percent for volume and 0.01 percent for unit costs. The increase in unit costs expected for 1990 arises from initiatives in the fiscal area and from operational changes that are producing a fall-off in the volume of coin.

1989 Budget Performance

The Board in December 1988 approved 1989 Reserve Bank budgets totaling \$1,330.5 million, an increase of \$69.2 million, or 5.5 percent, over estimated 1988 expenses. The Reserve Banks now estimate 1989 expenses at \$1,341.4 million, which is \$10.9 million, or 0.8 percent, over the 1989 budget and 6.3 percent over actual 1988 expenses. Nine Reserve Banks estimate that their 1989 spending will exceed their 1989 budgets, although six of the nine expect the excess will be less than 1 percent. The budget overruns are due to several unanticipated events: higher costs for activities covered by the Expedited Funds Availability Act (EFA); the crisis in the savings and loan industry; and a change in the allocation of Contingency Processing Center (CPC) costs between the Board and the Reserve Banks.

In planning activities under EFA, the Reserve Banks underestimated the volume of return items and overestimated their quality. The cost of EFA-related activities is now estimated at \$29.2 million, \$9.9 million more than the \$19.3 million budgeted. Eleven Reserve Banks have excess EFA-related expenses; the largest are being reported by Atlanta, whose entire budget overrun of \$3.0 million is for EFA, and San Francisco, whose total overrun of \$4.1 million contains \$2.5 million of unbudgeted EFA costs. (Another major factor in San Francisco's total overrun is an unplanned 18.8 percent increase in the volume of

Table 3.13
Changes from 1989 to 1990 in Volumes
and Unit Costs of Federal Reserve
Bank Services

Percent

Service	Volume	Unit cost
Payments	3.6	.5
Commercial checks	1.5	2.3
Automated clearinghouse	14.1	-7.6
Funds transfers	5.5	-2.0
Other	2.1	3.0
Cash	2.9	3.7
Currency	4.6	2.6
Coin	-6.9	10.2
Fiscal agency	1.3	5.6
Savings bonds	6.8	5.3
Other Treasury issues	-13.0	7.1
Other fiscal agency	2.2	6.2
Treasury Direct	-6.3	3.5
Securities and noncash services	-7.6	10.7
All	3.0	1.8

currency handled at the Los Angeles Branch, which raised processing costs \$1.1 million.)

The continuing attention to problem banks and savings and loan institutions contributed to the estimated \$1.8 million overrun in the Dallas District. Dallas added resources to handle unbudgeted growth of volume in the payments and fiscal areas that resulted when depository institutions shifted their activities in these areas to the Dallas Bank. In addition, Dallas added resources to address the District's growing requirements for inspection, examination, surveillance, and monitoring of problem financial institutions.

The unanticipated change in the allocation of CPC costs between the Board and the Reserve Banks raised the share of the Reserve Banks \$1.8 million. ■

Part II

Special Analysis

Chapter 4

Regional Delivery System for Over-the-Counter Savings Bonds

Over the next few years, the Department of the Treasury in cooperation with the Federal Reserve will establish a network of regional centers to issue Series EE savings bonds. By 1994, when the system is fully in place, the public will still be able to enter any one of nearly 40,000 depository institutions to buy savings bonds. But under the new organization known as the Regional Delivery System, twelve regional Reserve Bank offices, instead of the depository institutions themselves, will actually inscribe and issue the bonds. The Treasury expects that, when complete, the consolidation will save U.S. taxpayers more than \$18 million per year in administrative costs and permit technological innovations to make the program thereafter even more cost-effective.

Over-the-Counter Savings Bonds

Since the introduction of the first series of U.S. savings bonds in 1935, the Treasury has sought ways of encouraging individuals to participate in the financing of the public debt while reducing the inevitably large administrative costs of widespread issuance. The Treasury has long been interested in alternative methods of processing applications for over-the-counter purchases, the most labor-intensive work in the entire savings bond program. Currently, the Treasury sells Series EE bonds to the public through payroll deduction, through over-the-counter sales at the Federal Reserve Banks, and through over-the-counter sales at nearly 40,000 depository institutions serving as issuing agents. Before the RDS pilot

program, Reserve Banks issued about 1 percent of all bonds sold over the counter.

To purchase a bond over the counter, a customer completes an application, presents payment, and receives a bond inscribed with the requested ownership information, all during the same visit. In the fiscal year ended September 30, 1989, 15 million walk-in customers bought more than 27 million Series EE bonds with an issue value of \$4.4 billion.

The Pilot Program

Testing of the Regional Delivery System (RDS) began in October 1987 with a pilot program in the Pittsburgh Branch of the Federal Reserve Bank of Cleveland. Initially limited to depository institutions in Ohio, which accounted in 1988 for 4.7 percent, or about \$143 million, of all over-the-counter Series EE bond sales, the pilot program was expanded to the rest of the Cleveland District in 1989 (western Pennsylvania, the West Virginia panhandle, and eastern Kentucky).

The Ohio pilot saved more than \$300,000 in 1988 without degrading service to the public. Depository institutions in the Cleveland District favored the program; with bonds mailed by the Pittsburgh Branch within a few days, customers made little complaint about the new system (especially given the immediate issuance of a gift certificate when a bond was purchased as a gift); and sales did not suffer. The pilot also paved the way for certain technologies, such as optical recognition devices, bulk data transmissions, multiuse terminals,

and personal computers, that may lead to further economies.

National Application of RDS

Nationwide implementation of RDS began in 1989 and will continue through 1993. In 1989, the Minneapolis District completed testing of the RDS software to be shared by some Districts and began implementing the delivery system in Montana. In 1990, three Districts — Richmond, St. Louis, and Kansas City — expect to fully implement RDS, and three more — Philadelphia, Chicago, and New York — expect to partially implement it. The remaining four Districts begin implementation in 1991. Based upon the experience with RDS through 1989, the Treasury anticipates annual savings to the public of \$18.5 million beginning in 1994 (table 4.1).

In addition to reducing the costs borne by taxpayers, the RDS will reduce those borne by sales agents. Although the fees paid by the Treasury to agents will decrease from eighty-five cents per bond issued to fifty cents per application, the agent may improve its net position on each transaction because it will no longer keep an inventory of bonds, inscribe and

issue them, or report sales. Estimates of the costs of agents, however, are not available.

Treasury and Reserve Bank Operations

The Federal Reserve Act declares that the Federal Reserve Banks serve as fiscal agents of the United States at the direction of the Secretary of the Treasury; the savings bond functions of the Reserve Banks, which cost an estimated \$40.7 million in 1988, are the largest component of the fiscal services they provide to the Treasury. These functions include issuing, servicing, and redeeming savings bonds sold both over the counter and through payroll deduction. The over-the-counter portion of the savings bond functions, which involve managing the network of agents that issue bonds, was nearly \$10 million in 1988.

Under the RDS, issuing agents are essentially sales agents because they no longer inscribe or issue bonds. Instead, they receive applications and payments for bonds and forward them to a designated Federal Reserve office. The new processing responsibilities for Federal Reserve offices include verifying information on the applications, reconciling the applications with sales records submitted by agents, inscribing and mailing bonds to all over-the-counter customers, and paying fees to agents for accepting applications.

The RDS will shift to the Federal Reserve a great deal of the Treasury's work on over-the-counter purchases, and it will automate or eliminate much of the rest. The Treasury benefits from reduced expenses associated with maintaining stock, reduced fees paid to agents, improved collection of data, and an accelerated flow of sales proceeds into its account at the Federal Reserve.

Table 4.1

Distribution of Estimated Annual Reduction in Public Expenses for Over-the-Counter Bond Sales upon Full Implementation of the Regional Delivery System in 1994¹

Expense	Millions of dollars	Percent
Treasury services ²	6.4	35
Cash management	8.2	44
Agent fees	3.9	21
Total	18.5	100

1. Calculated in 1989 dollars.

2. Includes Reserve Bank expenses.

SOURCE: Department of the Treasury.

During the transition phase from 1989 through 1993, the Reserve Banks estimate that their costs to implement and operate the Regional Delivery System will total \$36.2 million—\$16.5 million for implementation and \$19.7 million for operation (table 4.2). In 1994, the first year after implementation, the Reserve Banks project operating expenses for the RDS at \$13.6 million, including the costs of approximately 400 RDS employees.

The Reserve Banks estimate that, in the absence of the RDS program, the cost of managing the network of agents issuing over-the-counter bonds during the 1989–94 period would have remained steady or possibly fallen because of some technological and management improvements.

Table 4.2

Estimated Annual Expenses of the Federal Reserve Banks to Implement and Operate the Regional Delivery System, 1989–93¹

Millions of dollars

Year	Implemen- tation ²	Operation ³	Total
1989	2.3	0	2.3
1990	5.5	1.3	6.8
1991	5.8	3.1	8.9
1992	2.1	4.8	6.9
1993 .....	.8	10.5	11.3
Total	16.5	19.7	36.2
MEMO			
1994	0	13.6	13.6

1. Calculated in 1989 dollars.

2. Includes capital outlays.

3. Does not include depreciation.

Appendixes

Appendix A

Mission and Operational Areas of the Federal Reserve System

The Federal Reserve Banks and the Board of Governors have established four major operational areas to account for their activities: monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, and services to the U.S. Treasury and other government agencies.¹ This appendix describes each of these areas in detail.

Monetary and Economic Policy

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through its ability to influence money and credit in the economy. The System has several tools to affect the availability and cost of the nation's money and credit: setting reserve requirements; setting the discount rate (which affects the cost of borrowing); and the primary tool of monetary policy, open market operations.

The seven-member Board of Governors sets reserve requirements, and it acts on requests from the Federal Reserve Banks to adjust the discount rate. The Federal Open Market Committee (FOMC) meets in Washington eight times per year, usually twice each business quarter, to set policies for System open market operations; it comprises the

Board, the President of the Federal Reserve Bank of New York, and, on a rotating basis, the presidents of four other Reserve Banks.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public in weekly and monthly statistical releases in such areas as the monetary aggregates, interest rates, bank credit, and exchange rates. The research staffs at the Board and the Reserve Banks use this information, along with data collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background for the Board and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. In addition, they conduct longer-run economic studies of issues at the regional, national, and international levels.

Supervision and Regulation

Under the authority of the Federal Reserve Act and the Bank Holding Company Act, the Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. Under the Bank Holding Company Act, the Board is responsible for assuring that all activities of bank holding companies are "closely related to banking and a proper incident thereto." The Board of Governors adopts regulations to carry out statutory directives and

1. Services to the U.S. Treasury and other government agencies is an operational area unique to the Federal Reserve Banks. The fourth operational area for the Board of Governors, System policy direction and oversight, provides resources for the supervision of Board and Bank programs and is discussed in chap. 2.

establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies; review applications for mergers, acquisitions, and changes in control from banks and bank holding companies; and take formal supervisory actions. The System makes available to the public nonidentifying information it periodically collects on the condition and income of banks and bank holding companies.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

In January the Board issued risk-based capital guidelines for state member banks and bank holding companies. The Basle Committee on Banking Regulations and Supervisory Practices, supervisory authorities from twelve major industrial countries, built the framework for the Board's requirements. The guidelines make regulatory capital requirements more sensitive to the risk profiles of banking organizations; take off-balance-sheet exposures into explicit account in assessing capital adequacy; and minimize disincentives to holding liquid, low-risk assets. The work of the Basle Committee acknowledges the growing internationalization of major banking and financial markets. The harmonization and strengthening of capital standards worldwide should contribute to a more stable and resilient international banking system and help mitigate the competitive inequality for international banks stemming from differences in national supervisory requirements.

During 1989 the System maintained the intensified supervision program for

state member banks and bank holding companies that was implemented two years ago as a result of the increase in the number of bank failures and problem banks. In 1989 the Board and the Reserve Banks examined approximately 870 state member banks, inspected approximately 2,700 bank holding companies and their subsidiaries, and reviewed approximately 2,257 international and domestic applications. The System also examined 50 distressed savings and loan associations early in the year.

The Board enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1989 the System conducted examinations for such compliance at about 640 banks.

The Board's supervisory responsibilities also extend to foreign operations of U.S. banks and, under the International Banking Act, to U.S. operations of foreign banks.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which consists of many independent systems designed to move funds among financial institutions across the country. The Federal Reserve distributes currency and coin, processes checks for collection, operates electronic funds transfer networks, and provides for transfers of securities and for coupon collection.

Ensuring that the supply of currency and coin meets the public's demand for cash is the responsibility of the Federal Reserve. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions. The Banks use highly sophisticated equip-

ment to count cash, identify counterfeits, and destroy currency that is unfit for circulation. In 1989 the Reserve Banks paid out \$254.4 billion in currency and \$4.8 billion in coin and destroyed \$59.8 billion of unfit currency.

The Reserve Banks collect and clear checks under the specific authority of the Federal Reserve Act of 1913. The Banks, Branches, and regional check-processing centers currently clear approximately 16 billion checks each year with an average daily value of more than \$42 billion. Most checks deposited with the Federal Reserve by financial institutions are collected on the day they are deposited or on the next business day.

The Federal Reserve also plays a central role in the nation's payments mechanism through its electronic wire transfer system, Fedwire. Depository institutions can draw on their reserves or clearing accounts at the Reserve Banks through Fedwire and transfer funds anywhere in the country within minutes. Approximately 6,377 depository institutions use Fedwire through direct computer connections with Federal Reserve Banks, and another 4,193 institutions use Fedwire through off-line means such as telephone and telex. During 1989, approximately 59 million transfers valued at about \$181 trillion were sent over Fedwire, an average of \$3.1 million per transfer and \$722 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing-account balances. Users of this net settlement service include local check clearinghouse associations, credit card processors, automated teller machine networks, and national and regional funds transfer networks. In 1989, approximately 767,000 net settlement entries were processed by the Reserve Banks.

Approximately 33,390 offices of depository institutions use the Federal Reserve's automated clearinghouse (ACH), which makes recurring payments electronically instead of by check. The depository institutions use the ACH for credit transactions, primarily to pay salaries and pensions, and for debit transactions such as preauthorized bill payments. Of the approximately 16,600 institutions receiving ACH transactions, 4,047 have electronic connections with the Federal Reserve; the others receive payment data via machine-readable magnetic tapes or paper registers. In 1989 the Reserve Banks processed more than 1.1 billion ACH transactions valued at about \$5.1 trillion; one-third of the transactions were for the federal government, and the rest were commercial.

The securities services provided by the Reserve Banks cover the handling of book-entry securities and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of government agency securities to transfer them to other institutions throughout the country. The Reserve Banks maintained approximately 28,341 book-entry accounts in 1989 and processed approximately 10.9 million securities transfers.

In the definitive securities service, the Banks store physical securities ineligible for maintenance on the book-entry system. The Federal Reserve held approximately \$22.3 billion of such securities at the end of 1989.

In its noncash collection service, the Federal Reserve processes coupons, bonds, and miscellaneous items such as bankers acceptances and certain checks and drafts. Coupon collection, which accounts for approximately 95 percent of the transactions in this service, amounted to about 3.4 million coupon envelopes in

1988 and 3.3 million coupon envelopes in 1989.

Services to the U.S. Treasury and Other Government Agencies

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Federal Reserve Banks, the government issues its checks and payments and collects its receipts. The Reserve Banks also process wire transfers of funds and automated clearing-house payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Federal Reserve Banks provide several unique services to the government. They monitor the tax receipts deposited in the 14,670 tax and loan accounts maintained by depository institutions designated by the Treasury to perform this function, they hold the collateral that those institutions pledge to support those deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all Treasury savings bonds and retirement plan bonds. In another unique fiscal service, the Reserve Banks redeem food coupons for the Department of Agriculture and destroy them. ■

Appendix B

Budget Processes

As a group, the Reserve Banks follow a budgeting process distinct from that of the Board of Governors. This appendix describes those processes and explains PACS, the planning and control system that the Banks use for accounting.

The Budget and Control Process of the Board of Governors

All levels of management at the Board take part in a planning, budget, and control process based on the calendar year. To ensure that all elements are coordinated and objectives are achieved, the administrative governor oversees the process under authority delegated by the Chairman.

The Board places expenses and employment in four operational areas: economic and monetary policy, supervision and regulation of financial institutions, services to financial institutions and the public, and System policy direction and oversight. Costs for data processing are charged as direct expenses to the four major areas according to usage. Expenses for other elements of support and overhead are allocated to the four areas in proportion to the shares of direct costs attributable to each area.

The Budget Schedule

Early each year, the divisions at the Board conduct strategic planning meetings. In May, the Board's functional oversight committees review, for the divisions under their purview, the plans for the following year and beyond. The Board's controller and staff director for management coordinate the oversight meetings and the controller simultaneously pre-

pares a budget estimate based on the current level of operation, taking into account anticipated initiatives discussed at the meetings and other factors such as wage increases, changes in costs of employee benefits, and inflation.

Using this projection of expenses, the controller prepares a proposed guideline for approval of the Board in June. The approved guideline is then used by the divisions for preparation of their budget proposals in the fall.

The objectives and budgets prepared by the divisions are reviewed with the controller, the staff director for management, and the oversight committees. After appropriate adjustments, the controller in coordination with the staff director for management prepares a consolidated budget for the administrative governor to present to the Board for final approval at a public meeting in December.

The Budget of the OIG

The Board's Office of Inspector General (OIG), in accordance with its level of statutory independence, prepares its proposed budget apart from the oversight and guideline process just described and submits it directly to the Chairman without formal staff review. As in all other matters, the Chairman is free to seek assistance in reviewing the budget of the OIG, and he may recommend changes before sending it to the Board for action along with the regular operating budget.¹

1. Operations of the OIG are also discussed in chap. 2 and appendix E.

Treatment of Capital Expenditures

In 1985 the Board began capitalizing certain assets and depreciating their value over appropriate time periods, instead of expensing them in their year of purchase. Capitalizing, which is in accordance with generally accepted accounting principles, more closely aligns the cost of capital assets with their periods of service and is consistent with the accounting practices followed by the Reserve Banks.

The capital budget is developed concurrently with the operating budget, following the same procedures. Although the capital budget is not covered by the guideline for the operating budget, depreciation and other costs such as maintenance that are associated with capital assets fall under the guideline because they are operating costs.

Financial Monitoring and Control

Each division constructs quarterly operating plans, which managers monitor and review throughout the year. The controller observes performance against budgeted targets and submits quarterly reports to the Board.

After a midyear review of current expenses with each division director, the controller and the staff director for management estimate expenses for the entire year and submit the estimate to the Board along with any recommendations for reallocations. The midyear review helps control current expenses and provides a baseline for analyzing budget requests. At the beginning of the next year, the controller and the staff director for management report to the Board on the previous year's performance against budget and operating goals.

Assessments

The cash requirement for operations during the first half of the year, which is estimated after the Board adopts its budget, is approved by the administrative governor in early January. As the Federal Reserve Act provides, the required amount is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. For the second half of the year, the cash requirement is estimated in June, and the second assessment is made in July. Funds are transferred quarterly to minimize cash balances held by the Board.

The Budget and Control Process of the Federal Reserve Banks

Each year the Federal Reserve Banks, like the Board, establish major operating goals for the calendar year, devise strategies for their attainment, estimate required resources, and monitor results of current operations and financial performance.

The Budget Process

A task force drawn from staff members of the Board and the Reserve Banks develops a proposed budget guideline for the coming year based on forecasts of changes in workload and productivity at the Reserve Banks. The Conference of First Vice Presidents and the Conference of Presidents of the Reserve Banks review the work of the task force and revise it if necessary before sending it to the Board of Governors. The Board determines the appropriateness of the proposed level of spending and at about midyear communicates the budget objective to the Reserve Banks for their guidance in developing plans and budgets. To plan for priced services, the Banks update a multiyear strategic statement.

The management of each Bank department develops its budget based on workloads, required initiatives, and the budget objective. Senior Bank officials review the departmental requests and together with the president and first vice president determine priorities for the overall budget level to be recommended to the Bank's board of directors. In the fall the Board of Governors approves the budget of each Reserve Bank as well as the fee schedule for priced services, which is developed simultaneously with the budget data.

The Capital Budget Process

The Reserve Banks account for capital expenditures in accordance with generally accepted accounting principles and, therefore, include depreciation of capital assets in expenses. Technical staff members at the Board review all plans for large capital expenditures, whether for buildings, automation equipment, furnishings, or land. The staff members then make recommendations to the director of the division of Federal Reserve Bank operations or to the Board of Governors, depending on the significance of the item or project.

Review at the Board of Governors

In the fall, analysts at the Board review the budgets of each Reserve Bank and note Systemwide issues to be addressed during the budget review. They analyze the executive summary and the statement of objectives in each budget in light of the Bank's own trends, plans at the other Banks, the System budget objective and the cost-recovery objectives for priced services. The product directors and the Pricing Policy Committee examine the

budgets for priced services.² A committee of three governors reviews the budget of each Reserve Bank and meets directly with the president and first vice president of each Bank to discuss issues and directions. Following review by the committee of three governors, all Bank budgets are sent to the Board of Governors for action at a public meeting in December.

Special Projects

Special projects are those few research and development efforts that have the potential for a major improvement in the nation's payments mechanism or in the Federal Reserve's ability to provide services. Because of their long-range importance, special projects are approved separately from the process described above, which focuses on operational costs. Although not included in the budget objective, these projects are individually approved by the conference of presidents and the Board of Governors, and their effect on total system outlays is carefully reviewed. Three such projects, described in appendix C, have been approved for 1990.

The Planning and Control System

The Planning and Control System (PACS), implemented by the Reserve Banks in 1977, is the fundamental cost accounting system for all the services provided by the Banks, whether priced or

2. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific Systemwide priced services. The Pricing Policy Committee comprises one governor, the Board's staff director for Federal Reserve Bank activities, the presidents of two Reserve Banks, and the first vice presidents of two other Reserve Banks.

nonpriced, special or routine. Under PACS, budgets can be compared to actual expenses by service and object, and the Board of Governors can compare the nancial and operating performances of the Reserve Banks.

PACS groups all costs by major services, shown here under the four operational areas and support and overhead (see the accompanying list). The costs of support and overhead, in turn, are fully allocated to the four operational areas. PACS offers a detailed analysis of all these services and activities, including productivity statistics (primarily unit costs and items per employee-hour),

“environmental” statistics (to clarify the differences among the Banks’ operating environments), and “quality” statistics (to measure performance).

PACS affords the Banks a review of expenses, an audit trail, and expense accountability. Through periodic on-site reviews, the Board confirms that the Reserve Banks are complying with PACS instructions and also with System guidelines set by the Board. In addition, the General Accounting Office and an outside public accounting firm have determined in independent examinations that PACS is an appropriate and effective accounting mechanism for the Federal Reserve.

Federal Reserve Bank Activities

OPERATIONAL AREAS

Monetary and economic policy

Economic policy determination
Open market trading

Supervision and regulation

Supervision of District financial institutions
Administration of laws and regulations
 related to banking
Studies of banking and financial market structure

Services to financial institutions and the public

Special cash service
Currency
Coin
Transfer of account balances
Automated clearinghouse
Commercial check
Other check
Book-entry securities
Definitive securities
Loans to depository institutions and others
Noncash collection
Public programs
Other

Services to the U.S. Treasury and other government agencies

Savings bonds
Consolidated operations—savings bonds
Other Treasury issues
Consolidated operations—other Treasury issues
Centrally provided Treasury and agency services
Government agency issues
Other Treasury and government agency services
Treasury and other government coupons
Food coupons
Government accounts

SUPPORT AND OVERHEAD

Support

Data services
Centrally provided support
Occupancy service
Printing and supplies
Centralized planning
District projects

Overhead

Administration
System projects and contingency processing center
Special projects
Mail
Legal
General books and budget and expense control
Files and records storage
Personnel
Purchasing
Protection
Motor vehicles
Library
Telephone
Audit

Appendix C

Special Categories of System Expense

This appendix discusses System expenses for priced services, capital assets, special projects, and currency.

Priced Services

The Monetary Control Act of 1980 (MCA) requires the Federal Reserve to make available to all depository institutions, for a fee, certain services that the Federal Reserve had previously provided without explicit charge and only to member banks. As the act requires, the cost of providing these services includes all direct and indirect costs, the interest on items credited before actual collection (float), and the private sector adjustment factor (PSAF). The PSAF is the return on capital that would have been provided and the taxes that would have been paid had the services been furnished by a private business firm.

The Federal Reserve has developed an annual pricing process, which involves a review of Reserve Bank expenses in addition to the one required by the budget process, to meet the requirements for the full recovery of costs. Use of the budgets is an integral part of the pricing exercise because most of the recoverable costs of priced services consist of direct and indirect costs as determined by the budgets. To assist depository institutions in their planning to provide or use correspondent banking services, the Federal Reserve usually sets each year's prices only once, in the fourth quarter of the preceding year.

Fees for Federal Reserve services must be approved by the product director for the respective service, by the Pricing Policy Committee, and ultimately by the

Board of Governors.¹ If fees for any service are set so that the full recovery of costs is not anticipated, the Board announces the rationale.

The cost of float is estimated by applying the current federal funds rate to the level of float expected in the coming year. Estimates for income taxes and the return on capital are based on tax and financing rates derived from a model of the fifty largest U.S. bank holding companies; these rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year. The other components of the PSAF are derived from the budgets of the Reserve Banks: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital assets); the assessment for insurance by the Federal Deposit Insurance Corporation (FDIC) on expected clearing balances and on deferred funds for items deposited for collection with the Reserve Banks; and the portion of the expenses of the Board of Governors that is related directly to the development of priced services.

The inclusion of all these costs means the Federal Reserve offers its priced services on a basis comparable to that in the private sector, and the discipline of the market ensures that the prices charged will be no higher than necessary.

Calculation of the PSAF for 1990

In 1989 the Board approved a 1990 private sector adjustment factor of \$79.4

1. See appendix B, note 2, for a description of the position of product director and of the Pricing Policy Committee.

million, an increase of \$9.7 million, or 13.9 percent, from the PSAF of \$69.7 targeted for 1989.

Asset Base

The estimated value of Federal Reserve assets to be used in providing priced services in 1990 is \$6,714.2 million (table C.1). The value of assets assumed to be financed through debt and equity is \$487.7 million in 1990, an increase of \$42.7, or 9.6 percent, from 1989 (table C.2). This increase results largely from

capital expenditures for bank premises planned by the Reserve Banks next year and from an increase in the proportion of Reserve Bank premises required for priced services operations.²

Cost of Capital and Taxes

For imputing the 1990 cost of equity capital in the PSAF, the Board in 1989

2. Short-term assets are assumed to be financed by short-term liabilities; long-term assets are assumed to be financed by a combination of equity and long-term debt.

Table C.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 1989-90¹

Millions of dollars

Asset or liability	1989	1990
ASSETS		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances	283.3	286.3
Investment in marketable securities	2,077.9	2,099.4
Receivables ²	29.6	32.0
Materials and supplies ²	7.1	7.1
Prepaid expenses ²	6.2	9.6
Items in process of collection ³	<u>3,701.8</u>	<u>3,838.9</u>
Total short-term assets	6,105.9	6,273.3
<i>Long-term assets</i>		
Premises ^{2,4}	259.9	297.5
Furniture and equipment ²	142.6	141.5
Capital leases	<u>1.1</u>	<u>1.9</u>
Total long-term assets	403.6	440.9
Total assets	6,509.5	6,714.2
LIABILITIES		
<i>Short-term liabilities</i>		
Clearing balances and balances arising from early credit of uncollected items	2,794.0	2,838.7
Deferred-credit items	3,269.0	3,385.9
Short-term debt ⁵	<u>42.8</u>	<u>48.7</u>
Total short-term liabilities	6,105.9	6,273.3
<i>Long-term liabilities</i>		
Obligations under capital leases	1.1	2.0
Long-term debt ⁵	<u>156.8</u>	<u>139.1</u>
Total long-term liabilities	158.0	141.0
Total liabilities	6,263.9	6,414.3
Equity ⁵	<u>245.6</u>	<u>299.9</u>
Total liabilities and equity	6,509.5	6,714.2

1. Data are averages for the year.

2. Financed through the private sector adjustment factor; other assets are self-financing.

3. For 1989, restated to be consistent with the modifications to the calculation of the private sector adjustment factor approved by the Board in May 1989.

4. Includes allocations of Board of Governors' assets to priced services of \$0.4 million for 1989 and \$0.3 million for 1990.

5. Imputed figures representing the source of financing for certain priced-service assets.

approved the use of a five-year average of rates of return on equity earned by the fifty largest U.S. bank holding companies. The number of firms in the sample for 1989 was twenty-five. The five-year interval was chosen to reduce the variability of imputed costs caused by fluctuations in the earnings of bank holding companies. Also for the calculation of the cost of capital, the Board ended the

practice of deleting from the sample the holding companies with the highest and lowest returns on equity. The imputed pretax return on equity for 1990 is 15.5 percent.

Other Imputed Costs

Other required PSAF recoveries for 1990—imputed sales taxes, FDIC insurance, and Board expenses—total \$15.9

Table C.2

Derivation of the Private Sector Adjustment Factor, 1989–90

Millions of dollars, except as noted

Item	1989	1990
PSAF COMPONENTS		
<i>Assets to be financed</i> ¹		
Short-term	42.8	48.7
Long-term ²	402.4	439.0
Total	445.2	487.7
<i>Cost of capital (percent)</i> ³		
Short-term debt	6.6	7.3
Long-term debt	9.0	9.6
Pretax return on equity ⁴	16.9	15.5
Weighted average	13.8	13.6
<i>Capital structure (percent)</i>		
Short-term debt	9.6	10.0
Long-term debt	35.2	28.5
Equity	55.2	61.5
Total	100.0	100.0
Tax rate (percent) ⁴	20.5	27.8
REQUIRED PSAF RECOVERIES		
<i>Capital costs</i> ⁵		
Short-term debt	2.8	3.5
Long-term debt	14.0	13.3
Equity	41.4	46.6
Total	58.3	63.5
<i>Other costs</i>		
Sales taxes	8.0	9.9
Assessment for federal deposit insurance	1.9	4.3
Expenses of Board of Governors	1.4	1.7
Total	11.4	15.9
Total PSAF recoveries		
Millions of dollars	69.7	79.4
As a percent of capital	15.7	16.3
As a percent of expenses	13.8	14.2

1. The asset base for priced services is directly determined.

2. Total long-term assets less capital leases that are self-financing.

3. All short-term assets are assumed to be financed by short-term debt. Of the total long-term assets, 32 percent are assumed to be financed by long-term debt and 68 percent by equity in 1990. The data are average rates paid by the bank holding companies included in the sample.

4. The pretax rate of return on equity is based on average after-tax rates of return on equity for the sample of bank holding companies, adjusted by the effective tax rate. The 1990 figures for pretax equity is based on the average of these rates for the five years 1984–88.

5. The calculations underlying these data use the dollar value of assets to be financed, divided as described in note 3, and the rates for the cost of capital.

million, up from \$11.4 million approved for 1989 (table C.2). A large portion of the increase, \$2.4 million, is attributable to another change in the methodology approved by the Board earlier this year: The imputed FDIC insurance assessment now covers a measure of deposits including deferred credit items computed on a basis comparable to that used for a commercial bank. In addition, imputed sales taxes are projected to increase by \$1.9 million, largely as a result of an anticipated increase in expenditures by the Reserve Banks from 1989 to 1990.

Capital Outlays

In accordance with generally accepted accounting principles (GAAP), the Federal Reserve System depreciates the cost of fixed assets over their estimated useful lives. In the federal government, where no requirement exists for depreciation accounting, the cost of fixed assets is typically recorded as an expense at the time of purchase. However, the *Policy and Procedures Manual for Guidance of Federal Agencies* of the General Accounting Office, which governs accounting procedures in the federal government, specifies in title 2 the use of depreciation accounting for business types of operations and for activities that recover costs from reimbursements or user charges. Certain activities of the Federal Reserve meet both of these criteria. Under GAAP, the cost of acquiring an asset that is expected to benefit an entity over future periods should be allocated over those periods. Such treatment allows a more realistic measurement of operating performance.

The Banks capitalize and depreciate all assets that cost \$1,500 or more; they can either capitalize or expense assets costing less. The capitalization guideline for the Board is \$1,000.

The Banks maintain a multiyear plan for capital spending. The Board, in turn, requires the Banks to budget annually for capital outlays by capital class to estimate the effect of total operating and capital spending. During the budget year, the Banks must submit proposed major purchases of assets to the Board for further review and approval. The Board of Governors reviews capital expenditures for the Board.

Table C.3 shows total System outlays for recent years based on the federal government's typical practice of expensing assets. Total outlays for each year are derived from operating expenses less depreciation costs plus capital outlays. Because capital outlays are thus shown in total in the year of purchase rather than spread over the useful lives of the assets, the amounts and percentage changes vary widely from year to year.

Special Projects

For 1990 the Board of Governors has approved research and development on three projects intended to provide long-range benefits to the Federal Reserve and the banking industry. Because the spending on such projects is relatively high and short-term, the Federal Reserve accounts for it separately from its operating expenses.

Digital Imaging of Checks

In mid-1985 the Conference of First Vice Presidents authorized the testing of digital technologies to record check images for use in various check processing functions. The applications chosen for the testing were the archiving of check payment information for the Department of the Treasury and the processing of return items. These check processes had the strictest requirements of all, involving the storage of large amounts of data and

requiring a high level of quality in the retrieved image. The Treasury application is the largest user of microfilm in the Federal Reserve System, and one goal of the test is to determine whether digital technology can provide image quality that is at least equal to microfilm at lower cost. If successful, the technology could also help speed the processing of return items. Total 1990 expenses associated with this project are estimated to be \$1.6 million.

In 1990 the project will complete the testing of a prototype system integrated with existing high-speed check processors at two Federal Reserve Bank sites. Given the positive results to date, the

project will continue to focus on government checks and return items. A request for proposals will be issued in late 1990 for the Systemwide installation of check image processing.

A group of commercial banks has been exploring the new technology, primarily for use within a single Federal Reserve District, since December 1986. These institutions believe that in evaluating this technology, the Federal Reserve plays an important role, similar to the one it played in evaluating magnetic ink character recognition (MICR) in the 1950s. That is, the System can assure that the technology can support functions across Districts at the required speeds while

Table C.3

Total Outlays of the Federal Reserve System,
Federal Government Accounting Method, 1985-90¹

Millions of dollars, except as noted

Year and entity	Operating expenses	Depreciation		Capital outlays	Total outlays	Percentage change from previous year
		Equipment	Property			
	(1)	(2)		(3)	(1) - (2) + (3)	
1985						
Reserve Banks	1,117.4	60.3	21.1	148.2	1,184.2	9.2
Board of Governors	82.0	3.3	1.6	4.2	81.3	.6
Total	1,199.4	63.6	22.7	152.4	1,265.5	8.6
1986						
Reserve Banks	1,161.3	68.0	23.5	164.1	1,233.9	4.2
Board of Governors	84.0	4.2	1.6	16.5	94.7	16.5
Total	1,245.3	72.2	25.1	180.6	1,328.6	5.0
1987						
Reserve Banks	1,191.8	75.8	26.1	138.3	1,228.2	-.5
Board of Governors	86.3	5.9	1.6	5.0	83.8	-11.5
Total	1,278.1	81.7	27.7	143.3	1,312.0	-1.2
1988						
Reserve Banks	1,262.4	77.3	28.4	167.1	1,323.8	7.8
Board of Governors	90.5	5.9	1.6	3.3	86.3	3.0
Total	1,352.9	83.2	30.0	170.4	1,410.1	7.5
1989 estimate						
Reserve Banks	1,341.4	82.5	30.9	217.8	1,445.8	9.2
Board of Governors	96.3	4.3	1.6	4.0	94.4	9.4
Total	1,437.7	86.8	32.5	221.8	1,540.2	9.2
1990 budget						
Reserve Banks	1,419.0	92.7	35.0	274.9	1,566.2	8.3
Board of Governors	104.9	4.2	1.6	4.0	103.2	9.3
Total	1,523.8	96.9	36.6	278.9	1,669.4	8.4

1. Excludes costs of special projects and currency and includes costs of the Board's Office of Inspector General.

producing acceptable images and that the legal issues associated with image capture are addressed. The commercial bank effort might not have developed without the Federal Reserve's involvement.

Authentication of Currency

In 1988 the Federal Reserve initiated a special project for the development of an optical counterfeit-detection system (OCDS). During 1989 the project was expanded to include other means of authentication. The 1990 special project budget includes \$3.2 million in support of these developmental efforts.

In 1990 the Federal Reserve will request proposals from vendors to share the costs of continued development and testing of a prototype OCDS. This and several other efforts, both long-term and short-term, are designed to produce counterfeit detection devices to be placed on the Federal Reserve's high-speed currency processing equipment.

Processing Electronic Payments

A study by the Federal Reserve has indicated that, to meet the needs of users, the System must extend the number of hours it provides electronic payments services and that to better control risk in the payments system, it must improve the reliability of these services. The study also indicated that users of electronic payments are looking for more flexibility in the range of services offered as well as cost-effectiveness.

In April 1990 the Federal Reserve will complete its testing of equipment, known as the Electronic Payments Processor (EPP), to satisfy these requirements, at a 1990 cost of \$1.9 million. The EPP is a nonstop, fault-tolerant processor of the type used in networks of automatic teller machines and in payments processing at commercial banks.

The Federal Reserve, which installed the equipment at three Reserve Banks, is also developing software for the automated clearinghouse service and demonstrating the use of EPP equipment for the transfer of funds and securities.

Currency Printing

The Bureau of Engraving and Printing produces currency; the Federal Reserve Banks put it into circulation through depository institutions and destroy it as it wears out. The Federal Reserve Act stipulates that the costs of producing currency, as well as the costs of putting it into circulation and destroying it, are to be assumed by the Federal Reserve System (table C.4).

New currency is printed to replace worn notes and to accommodate increases in the demand for circulating currency (table C.5). Notes are also required for inventories held by the Reserve Banks to meet changes in demand.

To minimize the number of new notes ordered and the cost of their printing, the Board consults with the Bureau of Engraving and Printing to ensure that it uses

Table C.4

Currency in Circulation, New Notes Issued, and Notes Destroyed, 1989 Estimate

Millions of pieces

Dollar denomination	Notes in circulation ¹	New notes paid out ²	Notes destroyed ²
1	4,616	3,096	3,003
2	396	23	4
5	1,132	856	835
10	1,155	756	773
20	3,092	1,557	1,499
50	600	141	107
100	1,148	184	98
Total	12,139	6,613	6,319

1. As of September 1989.

2. Based on actual levels through the third quarter and expected levels for the fourth quarter. Notes paid out do not include additions to inventory at the Reserve Banks.

efficient methods, maintains System guidelines on the quality of notes, and sees that Reserve Banks do not destroy

notes prematurely. The Board and the Banks also monitor all related costs, such as those for transportation and packaging.

Table C.5

Costs to the Federal Reserve of New Currency, 1988-90

Millions of dollars, except as noted

Item	1988 actual	1989 actual	1990 budget	Percent change, 1989-90
Printing ¹	158.0	168.2	182.0	8.2
Shipping from Washington ²	5.2	4.2	4.7	11.9
Reimbursement to the Treasury for issuance and retirement	1.8	2.0	2.0	0.0
Total costs of currency	165.0	174.4	188.7	8.2

1. Based on 6.0 billion notes in 1988, 6.3 billion notes in 1989, and 7.0 billion notes in 1990.

2. Includes purchase of seals and labels for Bureau of Engraving and Printing.

Appendix D

Sources and Uses of Funds

The Federal Reserve System, in accordance with generally accepted accounting principles, accrues income and expenses and capitalizes acquisitions of assets whose useful lives extend over several years (see appendix C).

The System derives its income primarily from U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 90 percent of current income (table D.1).

The current expenses of the Reserve Banks consist of their operating expenses

and the costs of the earnings credits granted to depository institutions on clearing balances held with the Reserve Banks (table D.2). The Reserve Banks record extraordinary adjustments to current net income in a profit and loss account. The primary entries in the account are for gains or losses on the sale of U.S. government securities and for gains or losses that result either from the sale of assets denominated in foreign currencies or from the revaluation of those assets at market exchange rates.

The Reserve Banks retain a surplus to cushion unexpected losses, much as commercial establishments retain earnings. The Board of Governors requires that the surplus equal the capital paid in by the member banks. Since the end of 1964, the Board's policy has been to transfer to the Treasury all net income after paying the statutory dividend to member banks and the amount necessary to equate surplus to paid-in capital. The amount transferred is classified as interest on Federal Reserve notes. Such payments were \$17.4 billion in 1988 and are estimated to be \$21.6 billion in 1989.

Table D.1

Income of the Federal Reserve System,
1988-89

Millions of dollars

Source	1988 actual	1989 estimate
Loans	355.5	396.9
U.S. government securities ...	18,179.5	20,064.4
Foreign currencies	299.8	1,037.4
Priced services	656.8	702.4
Other	34.7	47.9
Total	19,526.4	22,249.2

Table D.2

Distribution of the Income of the Federal Reserve System, 1988-89

Millions of dollars

Item	1988 actual	1989 estimate
Current income ¹	19,526	22,249
LESS		
<i>Current expenses of Reserve Banks</i> ²		
Operating expenses	1,082	1,184
Earnings-credit costs	124	148
EQUALS		
Current net income	18,320	20,917
PLUS		
Net additions to, or deductions from (-), current net income ³	-489	1,296
LESS		
Cost of unreimbursed Treasury services ⁴	28	41
<i>Assessments by Board</i>		
Board expenses	84	90
Cost of currency	164	175
<i>Other distributions</i>		
Dividends paid to member banks ⁵	126	130
Transfers to, or from (-), surplus ⁶	65	131
EQUALS		
Payment to U.S. Treasury	17,364	21,646

1. See table D.1.

2. Net of reimbursements due from the U.S. Treasury and other government agencies. Reflects reductions of \$69.5 million in 1988 and \$46.7 million in 1989 in credits for net periodic pension cost.

3. This account is the same as that reported under the same name in the table "Income and Expenses of the Federal Reserve Banks," in the Statistical Tables section of the Board's *Annual Report* and includes gains and losses on foreign exchange transactions due primarily to revaluations at market exchange rates; gains and losses on sales of U.S.

government securities; and miscellaneous gains and losses.

4. The cost of services provided to the U.S. Treasury that are reimbursable under agreements with the Treasury and for which reimbursement is not anticipated.

5. The Federal Reserve Act requires the Federal Reserve to pay dividends to member banks at the rate of 6 percent of paid-in capital.

6. Each year the Federal Reserve transfers to its surplus account an amount sufficient to equate surplus to paid-in capital to provide a reserve against losses.

Appendix E

Federal Reserve System Audits

The Board of Governors, each of the Reserve Banks taken separately, and the Federal Reserve System as a whole are all subject to several levels of audit and review. At each Federal Reserve Bank, a full-time staff of auditors under the direction of a general auditor reports directly to the Bank's board of directors. The Board's Division of Federal Reserve Bank Operations, acting on behalf of the Board of Governors, regularly audits the financial operations of each of the Banks and periodically reviews all other Bank operations. The Board itself is reviewed by its own staff of auditors and operations reviewers; the responsibility for these internal reviews at the Board was consolidated in 1987 in a new Office of Inspector General. In addition, the Board retains an independent auditor each year to examine the fairness of its

financial statements and its compliance with laws and regulations affecting those financial statements.

General Accounting Office

The 1978 passage of the Federal Banking Agency Audit Act (Public Law 95-320) brought most of the operations of the Federal System under the purview of the General Accounting Office (GAO). The GAO, which currently has 26 projects in various stages of completion, since 1979 has completed 67 reports on selected aspects of Federal Reserve operations (tables E.1 and E.2). The GAO has also involved the Federal Reserve in about 57 other reviews not directly related to the System and has terminated 31 others before completion. The reports are available directly from the GAO.

Table E.1

Active GAO Projects Related to the Federal Reserve

Subject	Date initiated
Federal Reserve pricing of check clearing services	8/19/87
Government-in-the-Sunshine Act	9/17/87
Handling troubled financial institutions	3/14/88
Clearance and settlement in stock, options and futures markets	5/25/88
Electronic funds transfer systems	7/15/88
Food stamp program	8/24/88
Proposals for dealing with the international debt crisis	10/27/88
Federal tax deposits	11/16/88
Automated clearance and settlement systems	11/29/88
Regulation of government-securities brokers and dealers	1/9/89
Economic sanctions imposed on Panama	1/19/89
Foreign direct investment	2/9/89
Financial markets in Europe after 1992	2/23/89
International money laundering	3/8/89
Internal audit function	4/14/89
Mandatory flood insurance purchase requirement	5/1/89
Mortgage servicing transfers	5/19/89
Overseas securities activities	6/15/89
Securities activities by bank subsidiaries	8/16/89
Thrift and bank holding companies	8/17/89
Business takeovers and leveraged buyouts	8/18/89
Capital adequacy	10/6/89
Fraud backlog cases	11/8/89
Financial audit of bank insurance fund	11/20/89
Federal computerized systems containing personal information	11/21/89
East-West financial relations	12/1/89

Table E.2

Completed GAO Reports Related to the Federal Reserve System

Report	Number	Date
Comparing Policies and Procedures of the Three Bank Regulatory Agencies	GGD-79-27	3/29/79
Are OPEC Financial Holdings a Danger to U.S. Banks or the Economy ..	EMD-79-45	6/11/79
Federal Systems Not Designed to Collect Data on All Foreign Investments in U.S. Depository Institutions	GGD-79-42	6/19/79
Considerable Increase in Foreign Banking in United States since 1972 ...	GGD-79-75	8/1/79
Investment Policies, Practices and Performance of Federal Retirement Systems	FPCD-79-17	8/31/79
Federal Supervision of Bank Holding Companies Needs Better, More Formalized Supervision	GGD-80-20	2/12/80
The Federal Reserve Should Assure Compliance with the 1970 Bank Holding Company Act Amendments	GGD-80-21	3/12/80
Federal Agencies' Initial Problems with the Right to Financial Privacy Act of 1978	GGD-80-64	5/29/80
Internal Auditing Can Be Strengthened in the Federal Reserve System ...	GGD-80-59	8/8/80
Despite Positive Effects, Further Foreign Acquisitions of U.S. Banks Should be Limited until Policy Conflicts are Fully Addressed	GGD-80-66	8/26/80
Federal Examinations of Financial Institutions: Issues That Need to be Resolved	GGD-81-12	1/6/81
Examinations of Financial Institutions Do Not Assure Compliance with Consumer Credit Laws	GGD-81-13	1/21/81
Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings	AFMD-81-27	1/23/81
An Economic Overview of Bank Solvency Regulation	PAD-81-25	2/13/81
Federal Reserve Security over Currency Transportation is Adequate	GGD-81-27	2/23/81
The Federal Structure for Examining Financial Institutions Can be Improved	GGD-81-21	4/24/81
Response to Questions Bearing on the Feasibility of Closing the Federal Reserve Banks	GGD-81-49	5/21/81
Bank Secrecy Act Reporting Requirements Have Not Met Expectations, Suggesting Need for Amendment	GGD-81-80	7/23/81
Federal Reserve Could Improve the Efficiency of Bank Holding Company Inspections	GGD-81-79	8/18/81
Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of their Examination and Supervision Activities	GGD-82-5	10/19/81
Information on Selected Aspects of Federal Reserve System Expenditures ..	GGD-82-33	2/12/82
Federal Review of Intrastate Branching Can Be Reduced	GGD-82-31	2/24/82
Despite Improvements, Recent Bank Supervision Could Be More Effective and Less Burdensome	GGD-82-21	2/26/82
Issues to Be Considered while Debating Interstate Bank Branching	GGD-82-36	4/9/82
The Federal Reserve Should Move Faster to Eliminate Subsidy of Check Clearing Operations	GGD-82-22	5/7/82
Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes	GGD-82-57	6/1/82
Bank Merger Process Should Be Modernized and Simplified	GGD-82-53	8/16/82
An Analysis of Fiscal and Monetary Policies	PAD-82-45	8/31/82
Bank Examination for Country Risk and International Lending	ID-82-52	9/2/82
Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed	GGD-83-3	10/25/82
Survey of Investor Protection and the Regulation of Financial Intermediaries	GGD-83-30	7/13/83
Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information	GGD-83-13	8/25/83
Expediting Tax Deposits Can Increase the Government's Interest Earnings	GGD-84-14	11/21/83
Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision	GGD-84-40	2/3/84
Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission	GGD-84-4	2/3/84
Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York	AFMD-84-10	5/2/84
Statutory Requirements for Examining International Banking Institutions Need Attention	GGD-84-39	7/11/84

Table E.2
Continued

Report	Number	Date
Supervisory Examinations of International Banking Facilities Need to Be Improved	GGD-84-65	9/30/84
An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check Clearing Activities	GGD-85-9A	1/14/85
Difficulties in Evaluating the Effectiveness of the Community Reinvestment Act	OCE-86-1	11/4/85
International Coordination of Bank Supervision: The Record to Date	NSIAD-86-40	2/6/86
Implementation of the Export Trading Company Act of 1982	NSIAD-86-42	2/27/86
Information on Independent Public Accountant Audits of Financial Institutions	GGD-84-44FS	4/21/86
An Analysis of Two Types of Pooled Investment Funds	GGD-86-63	5/12/86
How the Markets Are Developed and How They Are Regulated	GGD-86-26	5/15/86
U.S. Banking Supervision and International Supervisory Principles	NSIAD-86-93	7/25/86
Financial Institution Regulators' Compliance Examination	GGD-86-94	8/1/86
The Market's Structure, Risks, and Regulation	GGD-86-80BR	8/20/86
Dealer Views on Market Operations and Federal Reserve Securities Transfer System	GGD-86-147FS	9/29/86
Questions About the Federal Reserve's Securities Transfer System	GGD-87-15BR	10/20/86
Federal Reserve Board Opposition to Credit Card Interest Rate Limits ...	GGD-87-38BR	4/7/87
Insulating Banks From the Potential Risk of Expanded Activities	GGD-87-35	4/14/87
The Federal Reserve Response Regarding its Market-Making Standard ...	GGD-87-55FS	4/21/87
Change in Fees and Deposit Account Interest Rates Since Deregulation ...	GGD-87-70	7/13/87
An Examination of Views Expressed About Access to Brokers' Services ...	GGD-88-8	12/18/87
Issues Related to Repeal of the Glass-Steagall Act	GGD-88-37	1/22/88
Preliminary Observations on the October 1987 Crash	GGD-88-38	1/26/88
Supervision of Overseas Lending Is Inadequate	NSIAD-88-87	5/5/88
Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States	NSIAD-88-171	6/2/88
Administrative Expenses at FHLBB and FRB for 1985 and 1986	AFMD-88-33	6/15/88
Trends in Commercial Bank Performance, December 1976-June 1987 ...	GGD-88-106BR	7/28/88
U.S. Commercial Banks' Securities Activities in London	NSIAD-88-238	9/8/88
Lending to Troubled Sectors	GGD-88-126BR	9/26/88
Government Check Cashing Issues	GGD-89-12	10/7/88
Conflict of Interest: Abuses in Commercial Banking Institutions	GGD-89-35	1/27/89
Competitive Fairness Is an Elusive Goal	GGD-89-61	5/12/89
Independent Audits Needed to Strengthen Internal Control and Bank Management	AFMD-89-25	5/31/89

Office of Inspector General

The Board established the independent Office of Inspector General (OIG) in July 1987 in accordance with the Inspector General Act of 1978, which requires thirty-three federal entities, including the Board, to establish such an office. The OIG plans and conducts audits, operations reviews, and investigations of the Board's programs and operations. In addition, the OIG reviews existing and proposed laws and regulations that affect the Board, making recommendations regarding their implications for adminis-

trative efficiency and for the prevention and detection of fraud and abuse. The OIG also coordinates its efforts with other governmental and nongovernmental agencies in the detection and prevention of fraud and abuse in activities administered or financed by the Board. The OIG makes semiannual reports of its activities and findings to the Chairman of the Board of Governors and to the Congress.

To date, the OIG has completed audits of the Board's procurement system and of its computerized docket system for bank holding company applications. These audits examined internal controls, com-

pliance with laws and regulations, general economy of operations, and achievement of program objectives. The OIG found that the procurement systems generally had adequate internal controls, complied with Board policies and procedures, and generally achieved stated goals and objectives. The audit of the bank holding company docket system found that it works well, meets the needs of its users, has an excellent response time, and provides appropriate checks to prevent and detect errors during the entry of data. ■

Appendix F

Expenses and Employment at the Federal Reserve Banks

Table F.1

Operating Expenses of the Federal Reserve Banks, by District, 1989–90¹

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	80,737	84,746	4,009	5.0
New York	261,585	276,832	15,248	5.8
Philadelphia	72,077	76,800	4,724	6.6
Cleveland	80,326	85,038	4,712	5.9
Richmond	102,853	110,503	7,650	7.4
Atlanta	127,181	134,992	7,811	6.1
Chicago	154,425	163,627	9,202	6.0
St. Louis	63,423	65,822	2,399	3.8
Minneapolis	66,374	68,122	1,748	2.6
Kansas City	87,011	92,560	5,549	6.4
Dallas	87,395	92,873	5,478	6.3
San Francisco	158,002	167,056	9,055	5.7
Total, all Districts²	1,341,388	1,418,972	77,584	5.8
Special projects	8,971	6,717	...	...
Total	1,350,360	1,425,689	75,330	5.6

1. Excludes capital outlays. In this and the following tables, the 1990 budget does not include reductions made in conjunction with Gramm–Rudman–Hollings; see appendix G.

2. Includes \$29.2 million in 1989 and \$28.2 million in 1990 to implement the Expedited Funds Availability Act.

Table F.2

Employment at the Federal Reserve Banks, by District, 1989–90

Average number of personnel, except as noted¹

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	1,519	1,471	–48	–3.2
New York	4,121	4,093	–28	–.7
Philadelphia	1,295	1,336	41	3.2
Cleveland	1,488	1,519	31	2.1
Richmond	1,988	2,057	69	3.5
Atlanta	2,377	2,392	15	.6
Chicago	2,674	2,658	–16	–.6
St. Louis	1,249	1,230	–19	–1.5
Minneapolis	1,113	1,117	5	.4
Kansas City	1,724	1,716	–8	–.5
Dallas	1,686	1,708	22	1.3
San Francisco	2,610	2,594	–16	–.6
Total, all Districts²	23,843	23,890	47	.2
Special projects	32	23	...	...
Total	23,875	23,913	38	.2

1. See chap. 3, note 2, for definition of average number of personnel (ANP).

2. Includes 636 ANP in 1989 and 587 ANP in 1990 for implementation of the Expedited Funds Availability Act.

Table F.3**Expenses of the Federal Reserve Banks, by Operational Area, 1989-90**

Thousands of dollars, except as noted

Operational area	1989 estimate	1990 budget	Change	
			Amount	Percent
Monetary and economic policy	93,198	98,874	5,676	6.1
Supervision and regulation	196,915	214,478	17,563	8.9
Services to financial institutions and the public	903,546	946,973	43,427	4.8
Services to the U.S. Treasury and other government agencies	147,730	158,647	10,917	7.4
Total	1,341,388	1,418,972	77,583	5.8
MEMO ¹				
Support	424,012	451,608	27,596	6.5
Overhead	371,454	395,224	23,771	6.4

1. Costs of support and overhead included in expenses by operational area. Support refers to activities, such as data processing, whose costs can be charged to users

according to amount of use. Overhead refers to activities, such as auditing, whose costs are charged according to the users' shares of total direct costs.

Table F.4**Expenses of the Federal Reserve Banks****for Monetary and Economic Policy, by District, 1989-90**

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	4,529	4,853	324	7.1
New York ¹	36,219	38,066	1,847	5.1
Philadelphia	3,791	3,985	194	5.1
Cleveland	4,931	5,123	193	3.9
Richmond	4,358	4,641	284	6.5
Atlanta	5,305	5,724	419	7.9
Chicago	7,464	8,143	679	9.1
St. Louis	4,673	4,933	260	5.6
Minneapolis	4,628	4,693	64	1.4
Kansas City	4,544	4,738	194	4.3
Dallas	5,075	5,593	518	10.2
San Francisco	7,683	8,383	700	9.1
Total	93,198	98,874	5,676	6.1

1. Expenses of open market trading operations, located in the District, are \$17.7 million for 1989 and \$18.9 million for 1990.

Table F.5

Expenses of the Federal Reserve Banks
for Supervision and Regulation, by District, 1989-90

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	8,676	9,963	1,287	14.8
New York	42,773	46,041	3,268	7.6
Philadelphia	9,136	10,604	1,469	16.1
Cleveland	10,453	10,740	288	2.8
Richmond	12,001	12,653	652	5.4
Atlanta	15,163	16,579	1,415	9.3
Chicago	27,262	29,770	2,509	9.2
St. Louis	7,948	8,397	449	5.7
Minneapolis	9,634	10,868	1,234	12.8
Kansas City	16,869	18,505	1,636	9.7
Dallas	15,793	17,377	1,584	10.0
San Francisco	21,208	22,981	1,774	8.4
Total	196,915	214,478	17,563	8.9

Table F.6

Expenses of the Federal Reserve Banks
for Services to Financial Institutions and the Public, by District, 1989-90

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	60,702	63,027	2,326	3.8
New York	147,986	156,985	8,999	6.1
Philadelphia	41,849	44,118	2,269	5.4
Cleveland	53,013	55,748	2,735	5.2
Richmond	77,721	83,031	5,311	6.8
Atlanta	95,600	100,605	5,005	5.2
Chicago	104,045	109,425	5,380	5.2
St. Louis	44,045	44,891	847	1.9
Minneapolis	46,893	46,806	-86	-.2
Kansas City	58,069	60,516	2,447	4.2
Dallas	59,498	62,406	2,908	4.9
San Francisco	114,128	119,416	5,288	4.6
Total	903,546	946,973	43,427	4.8

Table F.7

Expenses of the Federal Reserve Banks
for Services to the U. S. Treasury and Other Government Agencies, by District, 1989-90

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	6,830	6,903	73	1.1
New York	34,607	35,741	1,133	3.3
Philadelphia	17,301	18,093	791	4.6
Cleveland	11,930	13,427	1,497	12.5
Richmond	8,774	10,177	1,404	16.0
Atlanta	11,114	12,085	972	8.7
Chicago	15,655	16,289	635	4.1
St. Louis	6,757	7,601	843	12.5
Minneapolis	5,219	5,755	536	10.3
Kansas City	7,530	8,801	1,272	16.9
Dallas	7,029	7,497	468	6.7
San Francisco	14,983	16,277	1,293	8.6
Total	147,730	158,647	10,917	7.4

Table F.8

Expenses of the Federal Reserve Banks
for Salaries of Officers and Employees, by District, 1989-90

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	45,591	47,515	1,924	4.2
New York	135,968	143,549	7,580	5.6
Philadelphia	36,051	39,032	2,981	8.3
Cleveland	39,817	42,165	2,348	5.9
Richmond	51,874	56,226	4,352	8.4
Atlanta	63,136	66,208	3,072	4.9
Chicago	77,062	80,364	3,303	4.3
St. Louis	32,882	33,878	995	3.0
Minneapolis	30,960	33,061	2,101	6.8
Kansas City	47,172	49,923	2,752	5.8
Dallas	47,532	50,350	2,818	5.9
San Francisco	81,113	85,219	4,106	5.1
Total	689,157	727,489	38,332	5.6

Table F.9

Factors in the 1989-90 Change in Salaries
of Officers and Employees of the Federal Reserve Banks, by District

Percentage points

District	Merit adjust- ment	Structure adjust- ment	Promotion and reclassi- fication	Change in staffing	Turnover and lag ¹	Overtime	Other	Total change
Boston	4.9	.1	1.9	-5.0	2.8	-.8	.3	4.2
New York	5.4	.0	1.3	.7	-1.9	-.5	.5	5.6
Philadelphia	6.1	.9	.5	1.7	-.4	-.9	.4	8.3
Cleveland	4.5	.2	.8	2.1	-1.0	-.8	.1	5.9
Richmond	5.4	.0	1.8	3.8	-1.3	-1.3	.0	8.4
Atlanta	5.0	.2	1.1	.5	-1.3	-.5	.0	4.9
Chicago	3.7	.2	1.1	-.3	-.1	-.9	.5	4.3
St. Louis	5.0	.3	.8	-2.1	-.6	-.2	.0	3.0
Minneapolis	5.4	.1	.8	1.2	-.8	-.1	.2	6.8
Kansas City	5.8	.3	1.2	.0	-1.3	-.3	.0	5.8
Dallas	4.8	.1	.5	1.9	-1.1	-.2	.0	5.9
San Francisco	5.0	.0	.8	.0	-.1	-.6	.0	5.1
Total	5.0	.1	1.1	.4	-.7	-.6	.2	5.6

1. Turnover is the replacement of a departing employee with one having a lower pay grade. Lag is the time during which a position remains vacant.

Table F.10

Capital Outlays of the Federal Reserve Banks, by District, 1989-90

Thousands of dollars, except as noted

District	1989 estimate	1990 budget	Change	
			Amount	Percent
Boston	7,636	11,674	4,039	52.9
New York	40,309	59,813	19,504	48.4
Philadelphia	5,609	19,700	14,091	251.2
Cleveland	12,806	21,723	8,917	69.6
Richmond	22,436	21,987	-449	-2.0
Atlanta	26,652	25,493	-1,159	-4.3
Chicago	19,590	31,573	11,983	61.2
St. Louis	6,270	15,426	9,156	146.0
Minneapolis	8,413	12,236	3,823	45.4
Kansas City	10,459	9,073	-1,386	-13.3
Dallas	45,941	20,893	-25,048	-54.5
San Francisco	11,636	25,349	13,713	117.8
Total	217,756	274,940	57,184	26.3

*Table F.11*Budget Performance of the Federal Reserve Banks,
Operating Expenses, by District, 1989

Thousands of dollars, except as noted

District	1989 budget	1989 estimate	Change	
			Amount	Percent
Boston	80,422	80,737	315	.4
New York	261,139	261,585	446	.2
Philadelphia	71,400	72,077	677	.9
Cleveland	80,619	80,326	-293	-.4
Richmond	102,135	102,853	718	.7
Atlanta	124,211	127,181	2,970	2.4
Chicago	154,241	154,425	185	.1
St. Louis	63,734	63,423	-312	-.5
Minneapolis	66,391	66,374	-17	.0
Kansas City	86,803	87,011	208	.2
Dallas	85,562	87,395	1,833	2.1
San Francisco	153,829	158,002	4,173	2.7
Total	1,330,487	1,341,388	10,901	.8

*Table F.12*Budget Performance of the Federal Reserve Banks,
Employment, by District, 1989Average number of personnel, except as noted ¹

District	1989 budget	1989 estimate	Change	
			Amount	Percent
Boston	1,503	1,519	17	1.1
New York	4,037	4,121	84	2.1
Philadelphia	1,263	1,295	32	2.5
Cleveland	1,476	1,488	12	.8
Richmond	1,991	1,988	-3	-.2
Atlanta	2,271	2,377	105	4.6
Chicago	2,676	2,674	-2	-.1
St. Louis	1,246	1,249	3	.2
Minneapolis	1,113	1,113	0	.0
Kansas City	1,704	1,724	20	1.2
Dallas	1,623	1,686	63	3.9
San Francisco	2,538	2,610	72	2.8
Total	23,441	23,843	401	1.7

1. See chap. 3, note 2, for the definition of average number of personnel.

Table F.13**Expenses of the Federal Reserve Banks, by Operational Area, 1985-90**

Thousands of dollars

Year	Monetary and economic policy	Supervision and regulation	Services to financial institutions and the public	Services to the U.S. Treasury and other government agencies	Total
1985	90,945	151,991	742,896	131,544	1,117,377
1986	90,570	163,915	770,016	136,789	1,161,290
1987	86,484	170,428	799,227	135,693	1,191,832
1988	87,283	185,090	848,481	141,524	1,262,378
1989 estimate	93,198	196,915	903,546	147,730	1,341,388
1990 budget	98,874	214,478	946,973	158,647	1,418,972
MEMO					
Average annual change, percent	1.7	7.1	5.0	3.8	4.9

Table F.14**Employment at the Federal Reserve Banks, by Operational Area, 1985-90**Average number of personnel, except as noted ¹

Year	Monetary and economic policy	Supervision and regulation	Services to financial institutions and the public	Services to the U.S. Treasury and other government agencies	Support ²	Overhead ²	Total
1985	816	1,912	8,755	1,782	4,399	5,325	22,988
1986	791	2,088	8,800	1,820	4,470	5,275	23,243
1987	776	2,148	8,777	1,837	4,452	5,026	23,014
1988	766	2,209	9,033	1,819	4,562	4,951	23,337
1989 estimate	778	2,222	9,495	1,787	4,598	4,962	23,842
1990 budget	786	2,258	9,335	1,890	4,636	4,985	23,890
MEMO							
Average annual change, percent	-.7	3.4	1.3	1.2	1.1	-1.3	.8

1. See chap. 3, note 2, for definition of average number of personnel.

2. See table F.3, note 1, for definition.

Appendix G

Budget Reductions in the Spirit of the Gramm–Rudman–Hollings Legislation

The Board of Governors on January 11, 1990, approved a reduction of \$4.4 million in the 1990 budget of the Federal Reserve System to comply with the spirit of the Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as Gramm–Rudman–Hollings. The reductions will be prorated to each Reserve Bank and the Board according to the size and rate of increase of their budgets over the past three years. Both the method of determining the base subject to reduction and the proration among the Reserve Banks and the Board follow the approach the Board developed in 1986, when it made a similar reduction in the spirit of Gramm–Rudman–Hollings.

To reach the 1990 Gramm–Rudman–Hollings target deficit of \$100 billion, President Bush and the Congress agreed to efforts designed to reduce the fiscal 1990 deficit by \$14.7 billion, including a \$4.6 billion cut in federal spending. When spread over the entire fiscal year, the cuts would reduce nondefense programs 1.4 percent. In 1986, when the government took similar actions under Gramm–Rudman–Hollings to reduce the budget deficit, the Board strongly supported the effort and directed its staff to show how to apply the law's rules to the System's budget and operations.

The procedures developed then by the Board's staff and used again for 1990 call for determining a budget base subject to reduction in a manner consistent with that of agencies covered by the Gramm–Rudman–Hollings legislation. Generally, the expenses excluded from reduction are those for supervision and regula-

tion of financial institutions, those recovered through revenues and reimbursements, and those resulting from

Table G.1

Calculation of the Total Dollar Reduction in 1990 Budgeted Operating Expenses of the Federal Reserve System¹

Thousands of dollars, except as noted

Category	Amount
<i>1990 System operating budget</i>	
Reserve Banks	1,418,972
Board of Governors	104,990 ²
Total	1,523,962
LESS	
<i>1990 budget items excluded from reduction</i>	
Supervision and regulation	
Reserve Banks	214,478
Board of Governors	29,063
Total	243,541
Priced services ³	697,766
Claims for reimbursement	123,106
Retirement and other benefits ⁴	
Reserve Banks	54,129
Board of Governors	6,682
Total	60,811
Taxes on real estate ⁴	9,313
Prior-year obligations ⁴	
Reserve Banks	65,855
Board of Governors	6,074
Total	71,929
EQUALS	
Budget base subject to reduction	317,496
Percentage reduction applied to base ⁵ ..	1.4
Reduction in 1990 operating budget ...	4,445 ⁶

1. Reduction is in response to the Gramm–Rudman–Hollings legislation.

2. Figure used for Gramm–Rudman–Hollings calculation; final budget was subsequently reduced by the Board to \$104,853 thousand.

3. The average of priced services expenses (\$622,060 thousand) and priced services receipts and other income (\$773,473 thousand).

4. Retirement and other benefits are multiyear contractual obligations adjusted for the amount of these obligations included in supervision and regulation, priced services, and claims for reimbursement. Taxes on real estate and prior-year obligations cover equipment and building depreciation, rent, and equipment repair and maintenance expenses.

5. See text.

6. Before rounding, \$4,444,944.

contractual obligations. The reduction applied to the base, 1.4 percent, is equal to that required of the agencies covered by the law (table G.1).

The share of the \$4.4 million reduction to be borne by each Reserve Bank and the Board was calculated as an average of two factors—the entity's budget increase over the past three years

relative to the System's increase and the size of the entity's budget over the past three years relative to the total System budget (table G.2). The Reserve Banks and the Board staff must each provide the Board with a plan for achieving the cuts within their respective organizations and report the results to the Board at year-end.

Table G.2

Allocation among the Board of Governors and the Reserve Banks of the Total Dollar Reduction in the 1990 Federal Reserve System Operating Budget¹

Percent, except as noted

Entity	Expense ratio		Mean of expense ratios ⁴	Reduction in operating budget (dollars) ⁵
	Increase ²	Level ³		
	(1)	(2)	(3)	(4)
Board of Governors	7.59	6.76	7.18	318,947
<i>District</i>				
Boston	5.81	5.61	5.71	253,820
New York	18.76	18.21	18.44	819,609
Philadelphia	5.00	5.03	5.01	222,800
Cleveland	5.64	5.57	5.60	249,066
Richmond	7.32	7.21	7.27	322,974
Atlanta	10.64	8.81	9.72	432,189
Chicago	8.79	10.78	9.78	434,874
St. Louis	2.28	4.44	3.36	149,204
Minneapolis	3.67	4.55	4.11	182,733
Kansas City	6.10	6.08	6.09	270,867
Dallas	6.67	6.06	6.36	282,803
San Francisco	11.83	10.89	11.36	505,058
System	100	100	100	4,444,944

1. See table G.1 for calculation of total dollar reduction.

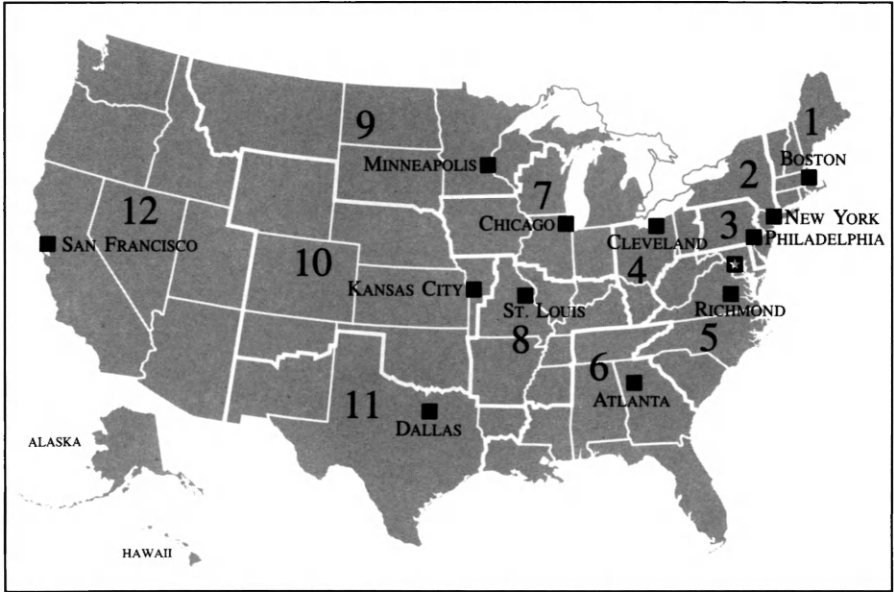
2. Dollar increase in 1988-90 expenses of the entity divided by 1988-90 System increase.

3. Total 1988-90 expenses of the entity divided by total 1988-90 System expenses.

4. Column 1 plus column 2 divided by two.

5. Column 3 divided by 100 and multiplied by \$4,444,944.

Maps of the Federal Reserve System



LEGEND

Both pages

- Federal Reserve Bank city
- Board of Governors of the Federal Reserve System

Facing page

- Federal Reserve Branch city
- Branch boundary

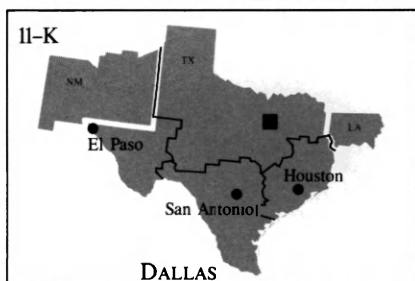
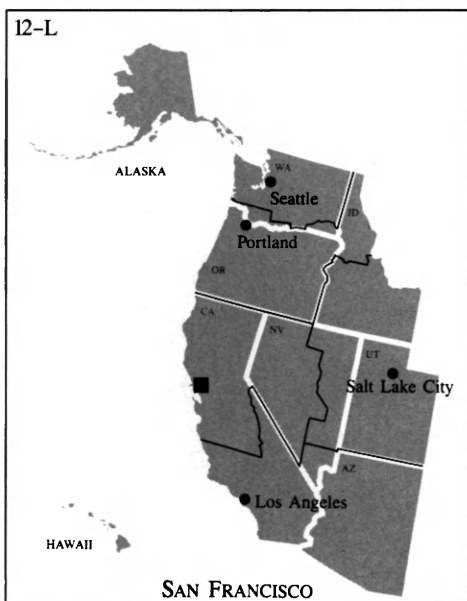
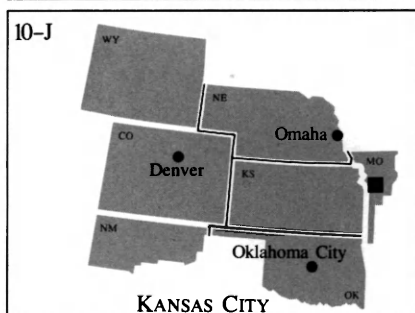
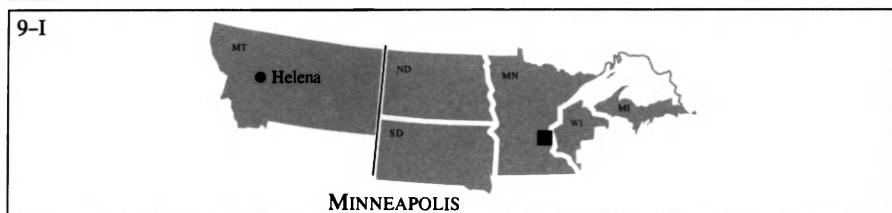
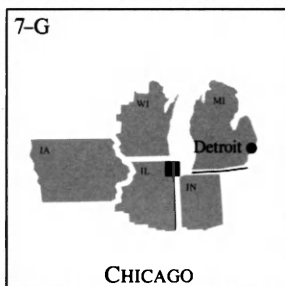
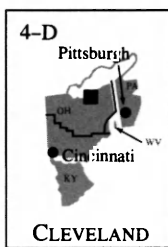
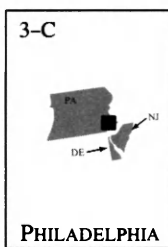
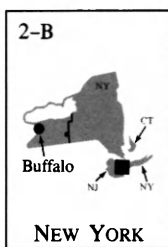
NOTE

The Federal Reserve officially identifies the Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York Bank serves the Commonwealth of Puerto

Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The Board of Governors revised the boundaries of the System most recently in August 1986.



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