Ms. Rivlin discusses the Federal Reserve's planning process and the efforts being made to improve performance Testimony of the Vice Chairman of the Board of Governors of the US Federal Reserve System, Ms. Alice M. Rivlin, before the Committee on Banking and Financial Services of the US House of Representatives on 29/7/97.

Mr. Chairman and members of the Committee, I am pleased to be here today to discuss the Federal Reserve's planning process and the efforts we are making to measure and improve our performance in the spirit of the Government Performance and Results Act (GPRA). I am personally a long-term proponent of GPRA and worked hard on its implementation when I was at the Office of Management and Budget. While the Federal Reserve does not receive appropriated funds and is not, strictly speaking, covered by the Act, we are eager to participate in the processes and activities set forth in the Act. GPRA fits well with the new efforts the Federal Reserve has undertaken to plan further ahead, use our resources more effectively and to coordinate activities across the whole system more explicitly. The testimony is a brief progress report on those efforts.

Planning at the Fed

In its briefest form, the Federal Reserve's mission is to "foster the stability, integrity and efficiency of the nation's financial and payment systems so as to promote optimal macroeconomic performance." This mission derives directly from the Federal Reserve Act of 1913, which established the Federal Reserve as the nation's central bank, and has three main elements:

> To formulate and conduct monetary policy toward the achievement of maximum sustainable long-term growth; price stability fosters that goal.
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> To promote a safe, sound, competitive, and accessible banking system and stable financial markets through supervision and regulation of the nation's banking and financial systems; through its function as the lender of last resort; and through effective implementation of statutes designed to inform and protect the consumer.
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> To foster the integrity, efficiency, and accessibility of US dollar payments and settlement systems, issue a uniform currency, and act as the fiscal agent and depository of the US government.

The activities involved in carrying out this broad mission are extremely diverse, ranging from setting short-term interest rates to processing checks and cash, to examining depository institutions. Allocation of the resources the Federal Reserve uses to do its job depends heavily on the state of the economy (both national and international), how well or badly the financial services system is functioning, and what additional tasks (such as implementation of the Community Reinvestment Act and expansion of our oversight of foreign banks operating in the US pursuant to the Foreign Bank Supervision Enhancement Act of 1991) the Congress assigns to us.

To carry out this multi-faceted mission, the Congress established a highly decentralized Federal Reserve System with a complex governance structure. Leadership and direction are vested in the Board of Governors, but only about 1,700 staff (out of about 24,900) work for the Board in Washington. The regional Reserve Banks carry out the bulk of operations and have substantial autonomy. As a result, planning and resource allocation at the Federal

Reserve have historically been quite decentralized, and major changes have required painstaking consensus building across the Board/Bank structure.

The regional structure of the Federal Reserve is one of its great strengths. The twelve regional Federal Banks work closely with the banks in their region and are closely tied into their regional economies. The development of Federal Reserve policy is greatly enriched by the in-depth knowledge that the regional banks have of the industrial, agricultural and financial forces shaping different parts of the economy. The challenge confronting strategic planning at the Federal Reserve is to find a balance between decentralized regional planning, which preserves the strengths of the regional structure, and the need for a more comprehensive national plan aimed at increasing efficiency by rationalizing the allocation of resources across regions and functions.

In recent years, major changes have occurred in the allocation of Federal Reserve resources in response to unfolding events. When serious problems developed in the banking industry in the 1980s and in response to increased supervisory responsibility for foreign banking entities, more Federal Reserve resources were channeled into supervision and regulation. Rapidly changing technology, especially telecommunications and automation, has revolutionized Federal Reserve operations and required considerable investment in hardware, software and expertise. Consolidation of the banking industry, evolution of payment systems patterns and technology, growth in derivatives, globalization of financial services, concerns about equal credit opportunity and fair housing issues, efforts to reduce systemic risk in the payments area, and changes in monetary aggregates, have all caused planning and resource adjustments.

Rapid technological change has also created opportunities for system-wide efficiencies resulting from consolidation of activities in one or more Reserve Banks. A number of the twelve regional banks have developed specialized activities serving other regions. For example, Federal Reserve Automation Services (FRAS) is headquartered in Richmond, but provides mainframe data processing and data communications services to all parts of the system. This consolidation and specialization has enabled the Reserve Banks to centralize operations of many of their mission critical applications, such as Fedwire, Automated Clearing House (ACH), and accounting. Continued technological advance, as well as further consolidation in the financial services industry, is likely to lead to further specialization among regional Federal Reserve Banks.

New Strategic Planning Activities

In the face of accelerating change, the Federal Reserve recently recognized the need for a more comprehensive planning framework. In 1995, a System Strategic Planning Coordinating Group was appointed, consisting of Board members, Reserve Bank Presidents and senior managers, representing the full range of the Federal Reserve’s activities. This group produced an “umbrella” framework, designed to enable the Board, the Reserve Banks and product and support offices to produce their own more detailed plans and decision documents under the “umbrella.”

This framework, which is the basis for the document submitted to the House and Senate Banking Committees, sets forth the mission of the Federal Reserve referred to above. It also discusses the “values” of the Federal Reserve, the goals and objectives of the Fed, key assumptions, as well as the external and internal factors that could affect the achievement of those goals and objectives. With the overall framework as a reference point, strategic planning activities are proceeding with new energy at the Reserve Banks, at the Board, and with respect to cross-cutting major functions such as the payments system and bank supervision and regulation.

Individual Reserve Banks have reviewed their operations from the ground up and reassessed their structure and effectiveness in carrying out their missions. Some of the Banks have launched fundamental re-engineering efforts that are resulting in substantial changes in management structure and operations. The Federal Reserve Bank of Chicago calls its effort “Fresh Look”; the Federal Reserve Bank of Cleveland is engaged in “Transformation: 2000.”

Board planning and budgeting

At the Board, we have restructured the annual planning and budget process to put more emphasis on planning (and less on detailed line-item budgeting), to lengthen the planning and budgeting horizon, and to involve the Board itself more heavily in setting priorities. To this end, we have established a Budget Committee of the Board (consisting of myself and Governors Phillips and Kelley) assisted by a staff planning group drawn from across the major functions of the Board. We are working with a four-year planning horizon and intend to produce the Board’s first biennial budget (1998/1999) to go into effect on January 1, 1998. Our hope is that the new process and structure will give the Board a better understanding of the options it faces with respect to alternative ways of carrying out the Federal Reserve’s mission, and a clearer basis for deciding on priorities.

Payments System study

A major study of the Federal Reserve’s role in the Payments System, currently underway, is another example of strategic planning with respect to a major portion of the Federal Reserve’s activities, under the general umbrella of the strategic planning framework.

Since payments technology and the structure of the financial services industry are changing rapidly, it seemed important to focus both on how the payment system was evolving (and should evolve) and what role the Federal Reserve should play in that evolution. The United States is amazingly dependent on paper checks -- Americans wrote 64 billion checks in 1996 -- while most of the industrial world is shifting rapidly to more efficient electronic based payments.

The study, directed by a committee of two Governors and two Federal Reserve Bank Presidents, has drawn on analytic resources across the Federal Reserve System and outside. We began by examining the consequences of substantially altering the role of the Federal Reserve in the retail payments system (checks and wire transfer system know as ACH). We analyzed the impact of scenarios ranging from withdrawal of the Federal Reserve from the check and ACH markets to more aggressive leadership by the Federal Reserve in making the payment system more efficient and less dependent on paper.

To get maximum input from the participants in the payment system -- banks, clearinghouses, vendors, consumers and others -- in helping us assess alternatives for the future, we held a series of “forums” around the country in May and June. We had enthusiastic and extremely helpful participation from a wide range of institutions. We learned a lot from the process and are now reassessing the alternatives, conducting additional analyses and preparing to present preliminary options to the Board. I look forward to sharing the study with this Committee.

The payments area is a good example of the dilemma posed for planners by rapid technological change. While rapidly evolving technology makes focussing on future options imperative, it also makes it extremely important to remain flexible. Laying out a blueprint for the payments system of the next ten or even five years, and rigidly following it, would almost certainly be a mistake. The technology is moving so rapidly that investments made now may well be obsolete in a short time.

Performance Measures

A major theme of GPRA is the identification of specific measures of performance of projects and programs which can be used to evaluate their effectiveness. As in most organizations, performance measurement at the Federal Reserve is more advanced -- and more feasible -- in some types of activities than in others.

In the payment services areas, the Reserve Banks have measured their performance through various financial measures for many years. For example, the Monetary Control Act of 1980 imposes market discipline on the Federal Reserve by requiring it fully to cover its costs of providing services to depository institutions, and compliance with this requirement is monitored closely. Frequently private competitors provide or could provide these services, and our ability to recover our costs, adjusted to include a factor for imputed profits, taxes and cost of capital, help determine whether it is beneficial for the economy that we stay in the business. In addition, the Federal Reserve has traditionally measured unit costs for its financial services and has developed various indices that allow a Reserve Bank to measure its cost performance over time and in comparison to other Reserve Banks. Private sector benchmarks are also being developed. The Federal Reserve also tracks quality measures for many Reserve Bank services. Finally, the Federal Reserve monitors the progress of the Reserve Banks against various strategic objectives.

Similarly, in bank supervision, the Federal Reserve has long used a variety of measures of the effectiveness of its examination process, but the measurement challenge has taken on new importance as supervision becomes more automated and more focused on analyzing risk. To meet this challenge, the Federal Reserve is working closely with other regulators to standardize and improve examination techniques, and has established a Steering Committee to oversee implementation of a risk-focused examination program and to design a management information system that will permit the Board to evaluate better the efficient use of examination resources among the Reserve Banks. For instance, supervisory data are used to determine in advance of on-site examinations what factors (CAMELS rating, asset size, location, and loan types) are most predictive as to the resources needed for examinations, and which institutions, particular lending areas or other service lines may require more intensive review. Such programs are low-cost because they use information that we already collect, and are effective and cost-saving because they provide a systematic way to plan and prioritize our time and resources.

In other areas, such as the research and statistical analysis on which monetary policy is based, performance measurement is -- and will remain -- far more problematic. The performance of the economy itself is not so hard to measure and right now is highly positive. But it is not clear how much of the economic progress can be attributed to monetary policy, and even less clear how particular monetary policy actions are related to the quality and quantity of research and analysis produced by the Fed’s research staff.

Conclusion

GPRA provides the opportunity for a major improvement in the management and effectiveness of Federal agencies. It provides the impetus for agencies to clarify their missions and objectives, measure their performance better and improve their efficiency and effectiveness. It must, however, avoid the risk of becoming, like some previous efforts to improve government management, largely a paper exercise which produces many numbers and reports but few real results.

The Federal Reserve welcomes the opportunity to participate in the GPRA process. We will work hard to fulfill the vision of the framers of the Act and avoid the pitfalls. We will have to respond in ways that are appropriate to the Federal Reserve's diverse missions and decentralized structure. I believe we have made significant progress toward the GPRA-type strategic planning and are on the track to making more in the immediate future.