

HEARINGS BEFORE THE HOUSE COMMITTEE
ON S. 417, FEBRUARY 16, 18, 1937

- Mr. Patman. If the Federal Reserve bank at Richmond wanted to increase its stock of Federal Reserve notes it would have a right to get these notes without paying any interest at all, would it not?
- Mr. Eccles. That is correct.
- Mr. Patman. Section 16 of the Federal Reserve Act says - that is, one part of it does, but I do not recall which paragraph it is - that when the Federal Reserve agent issues Federal Reserve notes the Federal Reserve bank shall pay such interest charge as may be agreed upon by the Federal Reserve Board, which I presume is the Board of Governors of the Federal Reserve Bank. What is the policy of the Board of Governors on carrying out that particular section of the law?
- Mr. Eccles. I am not familiar with the section to which you refer. I do not know just what you are attempting to prove, but the Federal Reserve banks as such, of course, have never paid interest. There is no one to whom they could pay interest. There was a time when they paid a franchise.
- Mr. Patman. I am not talking about the franchise, but about the part of this section.
- Mr. Eccles. To whom would they pay interest?
- Mr. Patman. It would go to the Treasury, I presume.
- Mr. Eccles. That is what the franchise tax was, of course. It was a form of that.
- Mr. Patman. And by the reason of the fact that there was a franchise tax and those excess earnings would go into the Treasury, the Board of Governors of the Federal Reserve Board fixed the zero rate of interest?
- Mr. Eccles. I could not say as to that.
- Mr. Patman. At any rate, they never charged any interest rate?
- Mr. Eccles. That is right.
- Mr. Patman. Since that time the law has been amended so that the excess earnings do not go to the Government, has it not?

- Mr. Eccles. Until such time as their surplus is built up to a certain amount.
- Mr. Patman. Are you not mistaken about that, Governor?
- Mr. Eccles. At the time the F. D. I. C. was organized there was \$149,000,000, as I recall it, of the capital of the Federal Deposit Insurance Corporation.
- Mr. Patman. That is not what I am asking about, if you will pardon my making the suggestion. And I think we can shorten this a great deal.
- Mr. Eccles. Then, what is your question?
- Mr. Patman. My question, Governor, is it not a fact now that excess earnings of the Federal Reserve banks go into the Treasury, as originally contemplated by the law?
- Mr. Eccles. That is correct. Of course, the Federal Reserve banks have practically no earnings. They have had practically none the past several years. It has been a very small amount.
- Mr. Patman. The excess earnings under the present law would go into the surplus fund of each bank?
- Mr. Eccles. Yes, sir; that is correct.
- Mr. Patman. And would not go into the Treasury?
- Mr. Eccles. That is correct.
- Mr. Patman. Was that the same reason that was given back in 1914 or 1915 as to why there should be no interest rate charged, because excess earnings go into the Treasury anyway? That reason is not logical now, is it, for the reason that the excess earnings do not go into the Treasury.
- Mr. Eccles. Inasmuch as the member banks are limited to a fixed rate of return on the capital, any earnings in excess of that fixed rate of return would go to the surplus of the Reserve banks. And, of course, they could not be utilized except as Congress determined..
- Mr. Patman. By special act of Congress?

Mr. Eccles. Yes, sir; by special act of Congress. In other words, any excess, in case of liquidation after the stock of the Reserve banks was retired at its par value, which would include all earnings, would accrue to the Government.

Mr. Patman. That is only in the event of liquidation, is it?

Mr. Eccles. Yes sir; or at any time that Congress decided, they could do just as they saw fit.

Mr. Patman. There is no question about that.

Mr. Eccles. So that the franchise tax, of course, would just eliminate any current earnings and may create a deficit.

HEARINGS BEFORE THE HOUSE COMMITTEE ON
H. J. RES. 377, JULY 14, 15 AND 23,
1937

Mr. Patman. Chapter 16 of the Federal Reserve Act says that when Federal Reserve notes are issued to a Federal Reserve Bank, the Federal Reserve Board, under the original law, should cause that Federal Reserve Bank to pay the interest rate that was fixed by the Federal Reserve Board, and I understand that at that time the Board met and said, "Well, all the excess earnings go into the Treasury, anyway, and we will just fix the zero rate of interest." Then in 1917 the law was amended, on June 21, 1917, so as to provide that the Federal Reserve Banks would only pay interest on the notes representing the difference between the gold certificates that were used as collateral security or gold and the amount of the notes issued, and I have checked that up since 1917, and my investigation discloses, from information that was obtained from your office that ever since that time some of these banks have obtained notes in violation of that law.

If that is true, I would like to know why the Board has not carried out that provision which requires an interest charge to be levied.

Governor Eccles. Well, as a matter of fact, it would seem that you are of the opinion, Mr. Patman, that private ownership of these reserve banks is a deterrent, that some one gets a particular advantage--

Mr. Patman. That is not the question at all. I am just asking about that specific point.

Governor Eccles. I could not answer that. The question has not come up since I have been connected with the Board. It is a question that has never been raised, and the Reserve System has been operating for the last three years with practically no profit whatever.

Mr. Patman. Well, of course, their income has been principally from Government bonds.

Governor Eccles. Entirely so, and it could not be from any other source.

Mr. Patman. Don't you believe that that law should have been complied with, Governor, and that those banks owe that money, that they still owe it, and should pay it now?

Governor Eccles. I do not know what rate you would fix upon the use of that currency, and if you fixed a rate on it, the Government would turn around and appropriate funds to the Reserve System to keep that going.

October 15, 1915.

SUBJECT: Interest Charges on
Federal Reserve Notes.

My dear Mr. Warburg:

The question whether the Federal Reserve Board may impose different rates of interest on the Federal reserve notes issued by the various Federal reserve banks involves a construction of that portion of Section 16 of the Federal Reserve Act which reads as follows:

"The board shall have the right, acting through the Federal reserve agent, to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes; but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank."

It will be observed that this paragraph provides in effect that any individual Federal reserve bank which has been granted an application for notes, whether in whole or in part, "shall pay such rate of interest on said amount as may be established by the Federal Reserve Board."

This provision clearly indicates that the Board may charge such rate of interest as it deems advisable on any particular or individual issue of notes, and there is no intention on the part of Congress, either express or implied, which demands that the Board fix a universal flat rate of interest on all Federal reserve notes. In other words, each separate issue of notes, whether to the same

or a different Federal reserve bank, may be subject to a different rate of interest.

A contrary result would defeat the obvious intent of Congress to enable the Federal Reserve Board to control, as far as possible, the conditions governing the demand for credit and to enable the Board to adapt not only re-discount rates but also the volume of Federal reserve notes to the varying needs of different sections of the country. There would not seem to be a more effective way of checking an undesirable inflation of credits than to enable the Board to impose different rates of interest on the various issues of Federal reserve notes. The paragraph quoted above clearly authorizes the Board to control not only the issue of notes to a particular bank but also to fix or determine the pressure to be put upon any particular bank to retire such notes when issued.

The fact that the authority to fix such a rate of interest is in precisely the same sentence as that empowering the Board to regulate the amount of notes issued to any individual bank, indicates that Congress had in view a method of controlling the circulation of Federal reserve notes in each individual district.

The wording of this Section is broad enough not only to permit of different interest rates in the different districts but also clearly authorizes the Board to charge each Federal reserve bank such rate of interest as it desires on each separate issue of notes made to that bank. The Act says that the Board may grant the application of any Federal reserve bank for Federal reserve notes, either in whole or in part, but to the extent that such application is granted, "such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board." In other words, Congress specifies, in discussing the application of any Federal reserve bank for notes, that the Board may grant so much of that particular application as it sees fit and shall charge such bank with the amount of notes issued and may establish such rate of interest as it sees fit "on said amount."

It seems clear, therefore, that the Board may, at the time of granting any application for Federal reserve notes, fix such rate of interest as it sees fit to be paid on the notes issued in compliance with that particular application, and this rate is in no way dependent upon any previous rate charged to that Federal reserve bank or to any other Federal

reserve bank.

It is not to be supposed, however, that, should the Board at the time of granting an application fail to fix any interest rate whatever, it is precluded from imposing any interest charge in the future, because the Act provides merely that the bank "shall pay such rate of interest x x x as may be established by the Federal Reserve Board," and it may be established either at the time of issue or at any time subsequent thereto that the Board desires.

There may be considerable practical difficulty if the Board fixes different rates of interest on different issues of notes made to the same Federal reserve bank, because of the question of determining when notes of the different issues are redeemed, but such a difficulty can in no way limit or restrict the legal rights of the Board in this connection. And it may be very easy to devise a method whereby, under mutual agreement, any notes retired by a Federal reserve bank will be assumed to be those on which the highest rate of interest is charged.

Respectfully,

(initialed) G.L.H.

Hon. Paul M. Warburg,
Federal Reserve Board.

April 28, 1916

Dr. Royall J. Miller,
No. 103 Peachtree Place,
Atlanta, Georgia.

S i r : -

Your letter of April 20th was duly received and referred to the Board for attention.

In reply you are advised that in the opinion of Counsel a discretion is vested in the Board as to what amount of interest, if any, shall be charged Federal reserve banks for the use of Federal reserve notes, and that in the exercise of its discretion the Board must take into consideration the purpose and intent of Congress.

It will be recalled that the banks pay all expenses of the preparation, issue and redemption of these notes; that unlike the tax on national bank note circulation the interest collected is not used for the purpose of defraying any of the incidental expenses; that after the payment of the expenses of the Federal reserve banks and the cumulative dividends on their stock, and after appropriating a certain amount to the surplus account of such banks, all of the earnings are paid to the Government in lieu of franchise and other taxes. To impose a tax, therefore, on Federal reserve notes merely as a means of raising revenue for the Government would not in the end increase the Government's revenue since it would merely increase the expenses of the banks and would thus deplete the amount that the Government receives from the earnings over and above the dividends on the stock.

One of the primary purposes of this provision was to enable the Federal Reserve Board to control the volume of notes of this character placed in circulation. In other words, if these notes become redundant the Board can, by imposing an interest charge or by increasing a charge already imposed, force a retirement and so furnish the desired elasticity to our currency. It has not been deemed necessary by the Board to force a retirement of these notes since the amount in circulation is no larger than is needed for the volume of business now being done by the banks. A nominal rate of interest, therefore, would serve no useful purpose and in the opinion of Counsel is not required under the law, nor would such a nominal charge seem to be within the purpose and intent of Congress.

I trust this will give you the information desired.

Respectfully,

Governor.

Ex Officio Members

David F. Houston
Secretary of the Treasury
Chairman
John Skelton Williams
Comptroller of the Currency

Address Reply To
Federal Reserve Board

W. P. G. Harding, Governor
Albert Strauss, Vice Governor
Adolph C. Miller
Charles S. Hamlin
Henry A. Moehlenpah

W. T. Chapman, Secretary
R. G. Emerson, Assistant Secretary
W. M. Imlay, Fiscal Agent

FEDERAL RESERVE BOARD
WASHINGTON

June 11, 1920.

X-1950

CONFIDENTIAL- NOT FOR PUBLICATION.

Subject: Proposed Interest Charge on Uncovered
Portion of Federal Reserve Notes Outstanding.

Dear Sir:-

The Federal Reserve Board is giving serious consideration to the advisability of imposing an interest charge upon the uncovered portion of Federal Reserve notes outstanding. Section 16 of the Federal Reserve Act provides in part, as follows:

"The board shall have the right, acting through the Federal reserve agent, to grant in whole or in part, or to reject entirely the application of any Federal reserve bank for Federal reserve notes; but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the banks so applying, and such bank shall be charged with the amount of notes issued to it and shall pay such rate of interest as may be established by the Federal Reserve Board on only that amount of such notes which equals the total amount of its outstanding Federal reserve notes less the amount of gold or gold certificates held by the Federal reserve agent as collateral security."

The Board calls attention to the large volume of Federal Reserve notes now in circulation and to the rate of increase in the amount outstanding during the past twelve months. Do the commerce and business of the country really require so large an issue?

It is not assumed, of course, that the imposition of an interest charge against Federal Reserve notes would or should have the effect of preventing the expansion of the total volume outstanding whenever there is an actual need for more currency. So far there have been no restraints, penalties, or costs imposed upon Federal Reserve note circulation, but the Board is of the opinion that it would be well to test the efficacy of some of the restrictive provisions of the Act.

A further consideration which has influenced the Board in its view is the fact that the large earnings of the Federal Reserve Banks are subjecting them to constant criticism and are a source of more or less dissatisfaction to member banks, whose participation in the earnings is limited to six per cent. cumulative dividends on the stock held by them. While it is true that the net earnings in excess of dividend requirements go to the Government of the United States, either directly in the form of a franchise tax or by additions to the surplus funds of the reserve banks which may reach the Government ultimately by reversion, the fact is generally overlooked that the large earnings of the banks are due to a great extent to their use of Federal Reserve notes.

The Board is inclined to the view, therefore, that it would be advisable to impose an interest charge on the uncovered portion of Federal Reserve notes outstanding, as provided in Section 16. This charge would constitute an item of expense to the Federal Reserve Banks and would effect a corresponding reduction in their net earnings.

Attention is called to the fact that while a specific tax is levied under the law upon Federal Reserve Bank notes, there is no tax levied against Federal Reserve notes, the Federal Reserve Board being authorized to fix the rate of interest which the Banks shall pay on the amount of their Federal Reserve notes outstanding not covered by gold or gold certificates deposited with the Federal Reserve Agents.

It appears therefore that the interest charge should be fixed with reference to current discount rates and that the Federal Reserve note issue should be no longer a source of appreciable profit to the Federal Reserve Banks. While reserving the right to take earlier action, the Board does not now contemplate making the proposed interest charge effective during the present calendar year, and it is proposed therefore to establish the charge as of January 1, 1921. This will afford ample opportunity for a thorough understanding of the matter and would make the rule effective at a time when there is normally a seasonal reduction in the volume of currency outstanding, whereas earlier action would make the change at a period when there is a strong seasonal demand for currency.

The Board requests that without giving publicity to this letter you bring it up for discussion at an early meeting of your directors or Executive Committee and transmit the substance of such suggestions or objections as may be made.

Very truly yours,

Governor.

To Chairmen of all F.R. Banks. Copy to Governors.