

Ex Officio Members

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David F. Houston

Secretary of the Treasury  
Chairman

John Skelton Williams

Comptroller of the Currency

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Address Reply To

Federal Reserve Board

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

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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CONFIDENTIAL- NOT FOR PUBLICATION.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.