330.0

C. J. Rhoads
Philadelphia

1915-1917
My dear Governor Strong:

I beg to acknowledge receipt and thank you for your favor of the 30th ultimo, enclosing circular letters and forms issued by the Gold Fund Committee in connection with the dissolution of the Fund and the distribution of the balances in their hands.

I imagine that most of the contributors to the Fund will avail themselves of either the first or second method of repayment, which will result in creating New York exchange, although it may not result in the Federal Reserve Bank of Philadelphia getting the benefit of all the repayments due to the Philadelphia subscribers.

Very truly yours,

Governor

HON. BENJAMIN STRONG, Jr.,
Governor, Federal Reserve Bank of New York.
Dear Floyd V. Hey,

Electrodynamics exhibits a number of peculiarities and is rich in potentialities. The electric field determines the behavior of charged particles. Your recent summary of the literature on electric field confinement is particularly interesting. I would be grateful to have a copy of the latest developments.

Please let me know if there are any plans to further develop this approach. I am anxious to see this project through to completion.

Sincerely,

[Signature]

FEDERAL RESERVE BANK OF NEW YORK
Dear Mr. Strong:

I have your letter of yesterday, stating that it would be convenient to you to have Governor Aiken and me meet you on Wednesday to discuss the matter of acting as fiscal agent for the Government, and write to state that I will come over on the 9 o'clock train Wednesday morning, which will bring me to your office about 11:15. If this hour conflicts with other engagements of yours, Aiken and I can talk over matters until you are free.

Will you also make a mental note to discuss with us briefly the new circular, received this morning, dated December 4, 1915, issued by the Federal Reserve Board, with reference to general open market operations.

Very truly yours,

Benjamin Strong, Jr., Esq.,
Governor,
Federal Reserve Bank of New York.
RECEIVED

DEC 6 1915 8 35 AM

FEDERAL RESERVE BANK
OF NEW YORK

I have your letter of yesterday, and regret that I was unable to give you the information at the time. I have spoken to Secretary of Commerce and Industry and it has been arranged with the government that I will come over at 12.30 this afternoon to see him. I trust this will be satisfactory. 

If you could make a start on the city if there is any possibility, either in the afternoon or after six, I should very much appreciate your efforts. 

Very truly yours,

[Signature]

Secretary, New York Reserve Bank.
January 11, 1917.

Enclosed is a copy of a letter prepared by the governors’ bond committee asking for proposals to purchase United States 3% Conversion Bonds which has been sent to the principal dealers in government bonds in the city of New York.

Will you not prepare identical letters and send them to dealers and investors in your district who, in your judgment, might be interested in bidding on a block of not less than $500,000. of these bonds.

Yours very truly,

Chairman.

P. S. Please advise me at Philadelphia the names and addresses of all parties to whom you send letters identical with the enclosed.
January 11, 1917.

Dear Sirs:

A committee acting in behalf of several of the Federal Reserve banks will shortly have for sale approximately $5,000,000 to $7,000,000 par value of U. S. 3% conversion coupon bonds, series of January 1, 1917, payable thirty years after that date.

On January 24, 1917, at 11 o'clock a.m., the committee will consider sealed proposals which have been received by it prior to that time for the purchase of said bonds on a cash basis for New York or Chicago delivery.

The committee will not consider any proposal for less than $500,000 par value of bonds and reserves the right to reject any or all proposals.

You are invited to submit proposals which should be addressed to Charles J. Rhoads, chairman, bond committee, care of the Federal Reserve Bank of New York.

Respectfully,

Chairman.
330

E. P. Parramore
Philadelphia
1917
E. P. Passmore, Esq.,
Governor, Federal Reserve Bank of Philadelphia,

Dear Mr. Passmore:

Referring to the Conference of Governors called by the Board for March 20th, Governor Strong feels that it might be worth while to take advantage of the opportunity to discuss matters of mutual interest which may not be on the programme prepared by the Board. I am consequently writing to all the governors with the suggestion that they be prepared to stay in Washington for several days to take up a variety of matters.

If this meets with general approval, I shall be very glad to prepare a programme. Will you send me at your earliest convenience such topics as you would like to have discussed at the meeting.

Very truly yours,

Deputy Governor.
My dear Governor Passmore:

For some time I have been interested with some friends in a study of some of the problems of our national financial system and particularly to the possibilities of a reform movement which might result in the establishment of a scientific plan for a Federal budget. The need for this has been made apparent to me during the past two years and as a result of contact with the financial machinery in Washington. Some of my friends believe the time is now opportune for a general attempt to interest the people of the country in national financial reform.

The campaign for saving, thrift and sensible spending, incident to the flotation of Government loans has put many of our people in a receptive mood for further suggestions in these matters. The national debt must be reduced and can only be reduced if both individuals and the Government practice sensible spending. It is particularly true with the Government but cannot be made possible until scientific machinery is installed to accomplish it.

Students of this subject seem to be in general agreement that a scientific budget system is the only solution. To persuade our people that such a system should be installed, a nonpartisan organization should be built up and a wise and sane campaign of publicity inaugurated. It is a plan of that sort in which some of my friends are interested with a view to activity after the next loan is placed. In the meantime, steps must be taken to prepare the publicity, and the personnel of the organization must be developed in advance.

It is, of course, out of the question to utilize the Liberty Loan organizations as such for an enterprise of this character. It does not, however, seem improper for me to ask you if in your experience with the Liberty Loan, War Savings, or other organizations in connection with the war, you have come in contact with individuals in your district who would be likely to be interested in this movement and who would
be qualified for service in such an organization and who would do so as a matter of public duty. What is first needed is a representative in every State, competent to take charge of the movement and direct it in the State. He should have qualifications to enable him to become a leader of the State movement, some ability as an organizer, should be public spirited, able to grasp the subject and willing to study it, and should be regarded locally as without political prejudice or purpose, and have the confidence in general of the people of the State.

In addition to state directors, similar organizers must be appointed in the various counties and principal cities.

I shall be greatly indebted to you if you can let me have suggestions and names of men in your district for this work without, however, mentioning the matter to them. You may know them well enough to make definite recommendations not only because you came in contact with them in Liberty Loan matters, but other public spirited activities with which you are acquainted or connected.

This is a matter in which I have a strong personal interest and will be grateful for your assistance. At our meeting in Washington on the 20th I hope to have an opportunity to refer to this matter more specifically.

Sincerely yours,

Governor.

E. P. Passmore, Esq.,
Governor, Federal Reserve Bank of Philadelphia,

BS/EK
September 14, 1921.

Dear Governor Norris:

You will recall that about two years ago we had some correspondence in regard to the work of the National Budget Committee. In part, at least, passage of the budget legislation by the Congress was due to the work conducted by that committee. Now that the basis of the budget system has been adopted by Congress, our organization is endeavoring to crystallize public sentiment for the support of the program of government economy and thereby to insure permanent success for the new national budget system.

We are seeking to extend this work by selecting, so far as possible, bankers to accept active chairmanships in various of the more important cities, simply to carry on work which will be laid out for them by the national committee. The scope of the work is described in the enclosed memorandum.

Can you suggest representative men, preferably bankers, who might be willing to accept such appointments in the cities of Philadelphia, Camden, Trenton, Wilmington, Reading, Erie and Scranton.

At the present time I shall only ask you to suggest names, but later on possibly you would be willing to communicate with them directly and further our object of having them accept these appointments.

If for any reason you think it unwise to make these suggestions, will you not write me quite frankly and, if you are willing to do so, give me your reasons.

With best regards, and thanking you very cordially, I am,

Yours very truly,

George W. Norris, Esq.,
Governor, Federal Reserve Bank of Philadelphia,
My dear Governor Strong:—

I have read with interest and care your letter of the 21st instant, in reference to reimbursement of fiscal agency expenses. I had supposed that Under Secretary Gilbert had clear and undoubted warrant for his voluntary offer to reimburse these expenses after June 30th, and must confess some surprise at what appears to be a substantial doubt as to the existence of such a right, or — at least — the propriety of exercising it. If the reimbursement is made, and the fact comes to the attention of Congress — as it inevitably would — there would be criticism not only of the Treasury Department for making the reimbursement, but also of the Federal Reserve Banks for asking and receiving it. It must be borne in mind also that the question would be raised at a time when Members of Congress would still be generally under the impression that the earnings of Federal Reserve Banks were large, and that the effect of the reimbursement had been simply to swell their surplus.

It would seem to me that in view of the doubt as to the propriety of the reimbursement, it would be better not to ask it until the Reserve Banks generally reached the point where they could not bear these expenses and earn their dividends, and that if this condition should arise, it would be better to lay the facts before Congress and get specific and unquestionable authority for the reimbursement.

On the other hand, I do not like to admit the principle that the Treasury Department may call upon Reserve Banks for any amount of service of any kind, and compel them to perform these services as part of their routine business, at the expense of their stockholders.

It occurs to me that perhaps the best solution would be for the Reserve Banks to make no claim for reimbursement, provided the Federal Reserve Board is willing to let us report our net earnings after deducting from our operating expenses the cost of performing fiscal agency functions, and then charge such cost to Profit & Loss under the general heading "Fiscal Agency Expenses", subdividing that item to a sufficient extent to show clearly the character and cost of the various services rendered. This would have the advantage of showing in a striking way the portion of our total expenses represented
by fiscal agency services, and would also serve to show to Congress that in addition to the cash payment of the franchise tax we were contributing services of very great actual money value.

As we are now getting close to June 30th, I would like to have your views on these suggestions, and also know what the sentiment is in the other banks. I presume that you wrote to the Governors of the other ten banks a letter similar to the one you wrote me.

I am,

Very truly yours,

[Signature]

Governor.

Mr. Benjamin Strong, Governor.
Federal Reserve Bank,
New York City.
Mr. J. H. Case, Chairman,
Open Market Investment Committee
of the Federal Reserve System,
Federal Reserve Bank,
New York City.

My dear Mr. Case:—

Governor Crissinger's letter to you under date of May 31st, which, in accordance with his expressed desire, you have brought to the attention of the Federal Reserve Bank of Philadelphia, was carefully considered at the semi-monthly meeting of our Board of Directors on Wednesday, the 6th instant, and I am directed to reply as follows:

Governor Crissinger's letter may properly be considered in two aspects - first, as it affects the Federal Reserve Bank of Philadelphia directly and exclusively, and secondly, in its broader or national aspect.

To take up the former aspect first. About a year ago the discounts of this Bank had fallen to a point which left us with very considerable funds temporarily unemployed. The volume of discounts was constantly shrinking. It was the judgment of the Board that this shrinkage was likely to continue for some time, and that the 65% of our deposits which we are at liberty to use would enable us, from that source alone, to meet any demands which our member banks might make upon us within a period of two or three years. This judgment, I may add, has thus far been verified. The low point in discounts was not reached until August, 1922, and there has never since been a time when our discounts amounted to 65% of our deposits.

This judgment having been reached, the next question for decision was whether all the rest of our resources should remain idle and unproductive, or whether we were charged with a duty to employ them. It would unduly prolong this letter to recite the considerations which led us to the latter conclusion. Suffice it to say that we did reach it, and that we have never regretted it, nor seen any reason to think that we made any mistake.
The third question was the amount of funds which should be employed. We decided that we might properly purchase government securities to an amount not exceeding our free capital and surplus. At the present time this investment represents only about 80% of our capital and surplus not already invested in building.

The last question was the manner of employment. Bankers' acceptances were then selling at 3%, and believing that this rate was unjustifiably low we were more disposed to curtail our purchases than to increase them. This left us only government securities. We deemed it better Reserve Banking policy to buy short-term notes than long-term bonds. As between short-term Treasury Certificates and longer term Treasury Notes, we chose the latter for three reasons — (1) because they paid a better rate, (2) because their purchase did not involve competition with member banks, and (3) because we thus avoided the necessity of re-investing the proceeds of frequently maturing Certificates. Our purchases were made slowly, without advancing the price of the Notes. We only bought part of what was offered to us by member banks or dealers. At no time did we make any bid, or place any open-market order.

Having exercised our best judgment in making these purchases; having seen our judgment thus far verified; and observing no injury that has resulted either to the Treasury Department or to the business and commerce of the Nation, we are reluctant to dispose of these securities, or any of them, particularly at a heavy loss, which loss can be avoided by simply holding them to maturity. I may add that our Board consented to the sale of our proportion of $50,000,000 only out of a desire to meet, as far as possible, the desires of the Treasury Department, and respect for the unanimous recommendation of the Committee. I was directed to advise you that the Board reserves full liberty and discretion to dissent from any future recommendation which the Committee may make.

As to the broader aspect of the question. The Board noted with some surprise the references in Governor Griswold's letter to "the policy of the (Reserve) Board," "the Board's determination," and the desire that you should call the matter to the attention of the Banks "in order that the policy of the Board may be carried out in its entirety." While the Federal Reserve Act does provide that purchases of government securities made by the Banks shall be subject to such rules or regulations as the Reserve Board may prescribe, we are not aware of any rules or regulations which the Board has ever prescribed on this subject, nor do we find in the Act any power given to the Board to prescribe any rules as to the sales of such securities, or any power to impose upon the Directors of the several banks a policy on this subject which is at variance with their own judgment. Such a policy, on the contrary, would seem to us to be utterly inconsistent with all the
other provisions of the Act, and would create an impossible situation, inasmuch as it would vest responsibility in one group and power in another group. There can be no doubt that the Federal Reserve System is a Regional and not a Central banking system, and the Act expressly provides that each Bank shall be conducted under the "control" of a Board of Directors, which shall "perform the duties usually appertaining to the office of directors of banking associations".

It has been and is the wish and policy of the Board of this Bank to do everything possible to meet the views of the Treasury Department and of the Federal Reserve Board on all matters, but it is felt that attention should be called to the fact that this willingness must not be construed as a willingness to surrender the powers expressly conferred by the Act, and naturally attaching to the degree of responsibility which Directors of Reserve Banks accept for the management of their several institutions.

I am,

Very truly yours,

(Signed) Geo. W. Norris

Governor.
other provisions of the Act, and would create an impossible situation, inasmuch as it would vest responsibility in one group and power in another group. There can be no doubt that the Federal Reserve System is a Regional and not a Central banking system, and the Act expressly provides that each Bank shall be conducted under the "control" of a Board of Directors, which shall "perform the duties usually appertaining to the office of directors of banking associations".

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I am,

Very truly yours,

(Signed) Geo. W. Norris

Governor.
September 14, 1923.

Dear Mr. Case:

I enclose herewith a draft of a letter to Secretary Gilbert, and supporting memorandum. This is nothing but a draft - dictated and not revised. Please feel entirely free, therefore, to suggest most radical alterations. After you have had time to consider it, and to draft the additions and amendments, let me know, and I will come over for a conference with you.

I am,

Very truly yours,

(Signed) Geo. W. Norris,
Governor.

Mr. J. H. Case, Deputy Governor,
Federal Reserve Bank,
New York City.
September 14, 1923.

Dear Mr. Case:

I enclose herewith a draft of a letter to Secretary Gilbert, and supporting memorandum. This is nothing but a draft - dictated and not revised. Please feel entirely free, therefore, to suggest most radical alterations. After you have had time to consider it, and to draft the additions and amendments, let me know, and I will come over for a conference with you.

I am,

Very truly yours,

(Signed) Geo. W. Norris,
Governor.

Mr. J. H. Case, Deputy Governor,
Federal Reserve Bank,
New York City.
Hon. S. P. Gilbert, Jr.,  
Under Secretary of the Treasury,  
Washington, D. C.

My dear Mr. Gilbert:

At the last Conference of Governors of the Federal Reserve Banks held in Washington in March last, there was a discussion as to the substitution of the "interest charge" on the uncovered portion of Federal Reserve notes, authorized in the 16th Section of the Federal Reserve Act, for the present payment to the United States as a franchise tax of the balance of earnings remaining after the payment of dividends on stock and appropriation to surplus.

It was the unanimous opinion of the Governors that such a change would be desirable, and the undersigned were appointed a committee to discuss the matter with you, and learn whether the Treasury Department would interpose any objection to such a change. You may recall that we had a moment's conversation with you on the subject immediately after the adjournment of the Conference, at which you raised the question as to the disposition of the surplus earnings remaining after the payment of the interest charge, 6% dividend on stock, and appropriation to surplus. We were not prepared at the moment to answer this question definitely, and beg leave to submit herewith for your consideration a memorandum in which the entire subject is quite fully discussed.

After you have had an opportunity to read this memorandum, and give the subject some consideration, we would like to have the opportunity to discuss it with you, in order that we may be able to make a report to the next Conference, which has been called for November 12th.

We are,

Very truly yours,
The 16th Section of the Federal Reserve Act, dealing with
the subject of Note Issues, provides that when the application of a
Federal Reserve Bank for Federal Reserve notes has been granted and
the notes supplied, 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."

It has been suggested that the purpose of this provision in
the Act is part of a "general disposition to place restrictions upon
the manufacture of credit". The opening sentence of the Section reads
"Federal Reserve notes, to be issued at the discretion of the Federal
Reserve Board, for the purpose of making advances to Federal Reserve
Banks through the Federal Reserve Agents as heretofore set forth, and
for no other purpose, are hereby authorized". It is popularly believed
that the provisions in regard to note issues, and particularly the pro-
vision that Federal Reserve notes, instead of being issued directly by
the Federal Reserve banks, should be issued by and bear the name of the
United States, were concessions in form rather than in substance to that
school of political economy which holds the view that note-issuing power
is primarily a function of government. It has been suggested that the
framers of the Act were concerned with fixing proper limitations on the
issuance of undue amounts of credit by the Federal Reserve banks, and that
this provision in regard to the interest charge on or the taxation of the
note issues is a part of that general disposition to place restrictions
upon the manufacture of credit. It is altogether probable that this was the thought underlying the provision. The same thought was in the minds of the members of the Federal Reserve Board in June 1920, when they advised the banks that they were giving serious consideration to the advisability of imposing this interest charge, with a view to preventing the then continuing increase in the volume of Federal Reserve notes in circulation, unless there was actual and unescapable need for more currency. They also called attention to the criticisms which were being made of the large earnings of the Federal Reserve banks, and to the fact that it was "generally overlooked that the large earnings of the banks are due to a great extent to their use of Federal Reserve notes".

Insofar as Federal Reserve notes are fully covered by gold, they are practically gold certificates, but it is manifest that an interest charge, accruing to the government, is a logical and natural charge for the right to issue notes not covered by gold, which are the obligations of the Government of the United States, and from the use of which the Federal Reserve banks derive a profit. When Governor Harding discussed this subject before the House Committee on Banking and Currency in 1921, he pointed out that the imposition of such an interest charge would be absolutely sure to yield a good return to the government, because whenever the earnings of the Federal Reserve banks were abnormally large, they would have outstanding an abnormally large uncovered note issue, and the tax or interest charge would be correspondingly large. He was obliged to admit, however, that the Federal Reserve Board was divided in opinion on the subject, and no action was taken on the matter.
The matter may be discussed from several points of view.

For the present purpose, the most important point is - How would the substitution of a 2% interest charge on uncovered currency outstanding, for the present government participation in profits, affect the income derived by the government from the operations of the Federal Reserve banks? One of the banks reports - "We paid to the government as a franchise tax for the year 1922 (exclusive of adjustments applicable to previous years) $855,363.90. A 2% tax or interest charge on uncovered currency outstanding would have amounted to $1,128,000, showing that the proposed change would have amounted last year to an increased payment of $272,636.10. This was due, however, to the fact that, having no inducement to keep down our uncovered currency, we retained a large amount of gold available for deposit with the Federal Reserve Agent. Had we deposited with the Agent all the available gold our uncovered currency would have been so far reduced that an interest charge of 2% thereon would have amounted to only $501,200, which would have been a saving of $354,163 from the franchise tax actually paid. If the interest charge had been 2 1/4% - half of the discount rate prevailing during the year - it would have amounted to $563,850, or a saving of $291,513 from the amount actually paid."

It is only fair to assume that if the tax or interest charge were to be substituted, the banks would deposit and maintain as collateral with the Federal Reserve Agents their entire reserves, except their 35% against deposits. The results for the last five years, calculated on this assumption, are shown in the following table:
## COMPUTATION OF NOTES SUBJECT TO TAX

**All Federal Reserve Banks**

(Under present wording of Federal Reserve Act)

(Figures in thousands)

<table>
<thead>
<tr>
<th></th>
<th>1918</th>
<th>1919</th>
<th>1920</th>
<th>1921</th>
<th>1922</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Average Net Deposits</td>
<td>$1,560,212</td>
<td>$1,735,179</td>
<td>$1,721,815</td>
<td>$1,713,589</td>
<td>$1,864,241</td>
</tr>
<tr>
<td>2. Average Total Reserves</td>
<td>1,976,000</td>
<td>2,190,000</td>
<td>2,120,000</td>
<td>2,652,000</td>
<td>3,145,000</td>
</tr>
<tr>
<td>3.35% of Item 1</td>
<td>546,074</td>
<td>607,313</td>
<td>602,635</td>
<td>599,756</td>
<td>652,484</td>
</tr>
<tr>
<td>4. Reserves available against Notes (2-3)</td>
<td>1,431,926</td>
<td>1,532,687</td>
<td>1,517,365</td>
<td>2,052,244</td>
<td>2,492,516</td>
</tr>
<tr>
<td>5. Average Notes in Circulation</td>
<td>1,689,000</td>
<td>2,606,000</td>
<td>3,148,000</td>
<td>2,691,000</td>
<td>2,219,000</td>
</tr>
<tr>
<td>6. Excess of 5 over 4</td>
<td>437,074</td>
<td>1,023,313</td>
<td>1,650,635</td>
<td>658,756</td>
<td>0</td>
</tr>
</tbody>
</table>

**Tax computed at 4%**

- 17,483
- 40,933
- 65,225
- 25,550

**Tax computed at 2%**

- 8,741
- 20,466
- 32,613
- 12,755

**Franchise tax paid**

(a) Includes $3,400 deducted from surplus account and paid to U. S. Government as franchise tax for 1921 and 1920. (1921 - $3,130; 1920 - $270)

(b) Includes $26,728 reserved for government franchise tax which was transferred to surplus fund in accordance with March 3, 1919, amendment to Federal Reserve Act.

(c) Includes $1,000 deducted from supersurplus account and credited to general reserve account of the Federal Reserve Bank of New York after closing books Dec. 31, 1920.

Computed from combined weekly condition reports of all Federal Reserve banks. Materially different results would be obtained by computing the tax for each bank separately. For example, it appears by the statement for September 12, 1923 (the last available at this writing) that while the ratio of gold reserves to Federal Reserve notes in actual circulation, after setting aside 35% against deposits, was 110.9 on that date for the System as a whole, that result was due largely to the fact that this ratio was over 150 in the New York bank. As a matter of fact, the ratio was less than 100 in seven of the twelve banks.
It should be borne in mind, in the first place, that it is more logical and more equitable that the government should get a direct return on notes on which it puts its name, issued by it to a corporation which uses these notes for profit, and that this return should be proportioned to the amount of the notes, than that it should forego any such direct return and then absorb all the surplus profits of such corporations, when in point of fact (taking figures for the year 1922) the funds used in making these profits consisted of over $300,000,000 capital and surplus and $1,864,000,000 average net deposits, both contributed by the member banks, and $2,219,000,000 notes, against which there was held an average available gold reserve of $2,492,000,000.

Such a change would also be in line with the practice followed by the governments of other great nations as to the taxation of central banks. The Bank of England pays to the government a lump sum of 180,000 pounds annually, in lieu of a stamp tax upon circulation. The Bank of France pays to the government a stamp tax upon productive circulation at the rate of .50 francs per 1,000 francs; upon unproductive circulation at the rate of .20 francs per 1,000 francs. Prior to 1914 the note-issuing banks of Germany were required to pay a tax of 5% per annum upon notes outstanding in excess of the "contingent" limit prescribed for each bank, the "contingent" circulation being that circulation in excess of cash holdings. Under the Statutes of 1900, the National Bank of Belgium paid to the government 1/4 of 1% each half-year on the excess of average circulation of notes above 275,000,000 francs. The Italian banks of issue pay a tax of 1/10 of 1% upon notes issued up to a fixed "normal limit" and a "supplementary normal limit" granted in 1914. Upon circulation in excess of these amounts a graduated tax is imposed equal to 1/4, 1/2, or 3/4, or the whole, of the discount
rate. The Bank of Japan is privileged to issue note currency up to its amount of gold and silver specie reserve without taxation. It may issue an additional 120,000,000 yen against government bonds or other approved security, subject to a tax of 1 1/4% per annum on the monthly average thus outstanding. When required by the exigencies of the market, it may make an excess issue subject to the approval of the Minister of State for Finance, taxed at not less than 5% per annum, the actual rate to be fixed on each occasion.

It is also to be observed that, if such a change were made, some reduction in the aggregate amount payable to the government over a period of years would be an entirely reasonable concession, inasmuch as the government would not only get a reasonably certain return in place of a wholly uncertain return, but would in addition get its share early in the division, instead of last. At the present time, the gross earnings of a Federal Reserve Bank are applied first to operating expenses, second to dividends, third to accretions to surplus, and fourth to the payment of the government franchise tax. Under the change suggested, the first charge on gross earnings would be the operating expenses, in which the interest charge or return to the government would be included, secondly dividends, and third accretions to surplus. After all three of these requirements had been made, there would still be a surplus of earnings, unless the interest charge were made unduly high, which brings us to the important question of what disposition should be made of this surplus.

The Federal Reserve Act as originally drafted by Senator (then Representative) Glass and passed in the House of Representatives, provided that the surplus earnings of Federal Reserve Banks, after the payment of
6% dividends, should go 60% to the government and 40% to the member banks. In the Senate, it was suggested that this surplus be used to build up a guarantee fund to protect depositors from loss in the event of the failure of banks that were members of the System. This proposed change was not acceptable to the House conferees, and the result was that the Bill finally took its present form. The capital and surplus and the great bulk of the deposits of Federal Reserve Banks have been contributed by the member banks. Upon their contributions to capital stock they receive 6% dividends, but upon their reserve deposits, which amount to eighteen times the capital stock, they receive nothing. This fact is unquestionably the most potential fact in deterring state banks from becoming members. Recognizing the very limited direct return which can be made to member banks, it has been the policy of the Federal Reserve Banks to be liberal in the rendering of "services" to member banks - paying charges on both incoming and outgoing shipments of currency, custody of securities, collection of checks and non-cash items, and various other things. Notwithstanding a very considerable liberality in these services, membership has proved attractive to only a very small proportion of the state banks, and many national banks chafe at what they regard as the injustice of the present division of earnings. The Federal Reserve Board has recently given unofficial intimations of a disposition to curtail these services. If such a change in policy is adopted, the accession of state bank members would almost entirely cease, and a considerable number of the present state bank members will withdraw, while the resentment or lack of interest on the part of national bank members will be intensified.

The idea of having a unified banking system, in which the great bulk of the banks of the country will participate, will therefore have to
be abandoned, unless some compensating advantage can be given them. The payment of interest upon their reserve balances is unsound and impossible. The only alternative, therefore, would seem to be to allow them some participation in the profits to which they have so largely contributed. Our suggestion would therefore be – first, that Section 16 of the Federal Reserve Act be amended to provide that the Federal Reserve Banks shall pay a rate of interest on their uncovered circulation equal to one-half of their average discount rate on commercial paper for the year; second, that Section 7 of the Act be amended to provide that after stockholders shall have received a dividend of 6%, and the authorized accretion to surplus fund shall have been made, 60% of the remaining earnings shall be paid to the United States as a franchise tax, and the remaining 40% divided among the member banks in proportion to the average reserve balances maintained; and, third, that both the interest charge on circulation and the 60% of final net earnings paid to the United States shall be used as it is now provided that the franchise tax shall be used.

We believe that these changes would not only be advantageous to the Treasury of the United States, but would also make the entire structure of the Act more logical and equitable; encourage banks to maintain full reserves, instead of keeping them down, as at present, to or below the legal limit; substitute good feeling and cooperation by those national banks whose membership is at present reluctant; and stimulate the accession of state bank members, thereby making the Federal Reserve Banking System what it was intended to be.

We venture to hope that the Treasury Department shares our belief that the proposed changes will strengthen the Reserve System by relieving it
from a considerable portion of the more or less political pressure in Congress to which it is now subject. As long as the United States Government remains the residuary legatee of all the earnings of the Federal Reserve Banks, the Congress will naturally be disposed not only to criticize, but to supervise and interfere. If it were possible to fix an "interest charge" which would approximate in amount to the present "franchise tax," we would favor the absolute elimination of the government as a participant in profits. Owing to the many uncertain factors in the calculation, that seems to be impossible. We would hope, however, that the interest charge suggested would, over a period of years, constitute the bulk of the government's profit from the operation of the banks, and would leave little divisible surplus. We would hope that 60% of this divisible surplus would not be sufficiently great in amount to justify the Congress in interfering with the building programs or routine operations of the Federal Reserve Banks.
September 26, 1923.

George W. Norris, Esq., Governor,
Federal Reserve Bank of Philadelphia,

Dear Governor Norris:

I regret that I have not been able to answer sooner your letter of September 14, with enclosures, in regard to the proposed amendment to the present provision of the Federal Reserve Act for payment to the United States of a franchise tax consisting of the balance of earnings remaining after the payment of dividends on stock and appropriation to surplus. I wanted to confer with Mr. Jay, Mr. Harrison, and Mr. Mason before renewing the verbal approval I gave you of the plan.

We are all agreed that the proposal is in general sound. But the division of earnings remaining after dividend to stockholders and accretion to surplus fund, on the basis of 40% to member banks and 60% to the United States as a franchise tax, is open to an objection. The principle we are seeking to establish is that the government shall not directly profit by contribution from our excess earnings. The plan, in so far as it provides for such a contribution to the government, violates this important principle. Do you not think it might be possible to devise some method of adjusting the tax, perhaps by a sliding scale, whereby an amount equivalent to about 60% of surplus earnings provided for the government by your plan could be made available to it in the form of a further tax on uncovered notes outstanding? Might not this be done without making the tax unduly high?

I should like very much to have your views on this, because it seems to me essential that we stand on the proposition that the reserve banks should pay...
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I should like very much to have your views on this, because it seems to me essential that we stand on the proposition that the reserve banks should pay
a note tax to the government rather than make a contribution to it from excess earnings and that we advance no plan inconsistent with this position.

You will of course understand that I am attempting here simply to address myself to the plan itself, without reference to the question of when it will be desirable to present it to Congress.

With kind regards,

Very truly yours,

J. H. Case
Deputy Governor.