TRANSFER TO TREASURY OF EXCESS EARNINGS OF FEDERAL RESERVE BANKS

The Board of Governors of the Federal Reserve System, under date of April 24, 1947, made the following announcement:

As a result of operations essential to Government financing during and since the war, and operations required by the needs of business and the public for credit and currency, earnings of the twelve Federal Reserve Banks have been at relatively high levels. On the basis of present estimates, it is expected that net earnings of the Federal Reserve Banks for 1947, after payment of the statutory dividends to member banks, will aggregate more than 60 million dollars. In view of these facts, and of the fact that at the end of 1946 the surplus of each Federal Reserve Bank was equal to its subscribed capital, the Board has decided to invoke the authority, granted to it under Section 16 of the Federal Reserve Act, to levy an interest charge on Federal Reserve notes issued by the Federal Reserve Banks. The purpose of this interest charge is to pay into the Treasury approximately 90 per cent of the net earnings of the Federal Reserve Banks for 1947.

This action will add about 60 million dollars to the receipts of the Government for this calendar year. The initial payment covering the first quarter of 1947 will be made on April 24, and will amount to approximately $15,269,000.

Section 16, paragraph 4, of the Federal Reserve Act provides that each Federal Reserve Bank shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on the amount of its outstanding notes less the amount of gold certificates held by the Federal Reserve Agent as collateral security. The Board has now decided to establish such rates of interest as will make it possible to transmit to the Treasury approximately 90 per cent of the net earnings after dividends of each of the Federal Reserve Banks for 1947.

The authority to levy an interest charge on Federal Reserve notes not covered by gold certificates has not been used previously, chiefly because of the existence, prior to 1933, of so-called franchise tax provisions of the law which had a similar effect; that is, of transferring excess earnings of the Reserve Banks to the Treasury. Under these provisions, which were repealed in 1933, each Federal Reserve Bank was required to pay a franchise tax to the Government equal to 90 per cent of its net earnings after it had accumulated a surplus equal to its subscribed capital. To the end of 1932, the Federal Reserve Banks had paid franchise taxes to the United States Treasury amounting to 149 million dollars, and at that time the Federal Reserve Banks had accumulated surplus accounts of 278 million dollars, as compared with subscribed capital aggregating 302 million. In the amendment of the Federal Reserve Act, contained in the Banking Act of 1933, providing for the establishment of the Federal Deposit Insurance Corporation, Congress required each Federal Reserve Bank to pay an amount equal to one-half of its surplus on January 1, 1933, as a subscription to the capital stock of the FDIC on which no dividends would be paid. These stock subscriptions amounted to 139 million dollars and reduced the surplus of the Federal Reserve Banks to an equivalent figure, or considerably less than one-half of their subscribed capital. Congress, therefore, eliminated the franchise tax in order to permit the Federal Reserve Banks to restore their surplus accounts from future earnings.

Net earnings for the next ten years were relatively small, and at the end of 1944 the combined surplus accounts of the Federal Reserve Banks were less than 75 per cent of their subscribed capital. During the next two years, however, net earnings increased substantially, due primarily to large holdings of Government securities accumulated through open market operations. This made possible transfers to surplus accounts which increased the combined surplus of the Federal Reserve Banks to $439,823,000 at the end of 1946, as compared with subscribed capital of $373,660,000.

Under the circumstances, the Board concluded that it would be appropriate for the Federal Reserve Banks to pay to the Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend. In effect, this will involve paying currently to the Treasury funds which,

under existing law, would otherwise come to it only in the event of liquidation of the Federal Reserve Banks. The Federal Reserve Act still provides that, in case of liquidation of a Federal Reserve Bank, any surplus remaining after the payment of all claims shall be paid to the Treasury. It is expected that the present payments will be made at quarterly intervals. By invoking its authority under Section 16 of the Federal Reserve Act, the Board is able to accomplish the same results as were accomplished by the payment of a franchise tax, i.e., the transfer of excess earnings to the Government. The payments can thus be reflected in current revenues and taken into account in the Government's budget without further legislation.

In the event of restoration of a franchise tax by the Congress, the Board would, of course, withdraw the requirement that Federal Reserve Banks pay interest on Federal Reserve notes, as there would be no justification for utilizing both means of accomplishing the same purpose—namely, payment of excess earnings of the Federal Reserve Banks to the Treasury.

In his Budget Message for 1948 the President recommended that Congress authorize the Federal Deposit Insurance Corporation to repay the 139 million dollars of capital furnished by the Federal Reserve Banks, and accepted the proposal of the Board of Governors that Congress at the same time authorize the payment of this sum to the Treasury instead of to the Reserve Banks. Similarly, the President in his Budget Message concurred in the Board's further recommendation that Congress release to the Treasury general fund approximately 139 million dollars earmarked for payments to the Reserve Banks to enable them to make loans to industry under Section 13b of the Federal Reserve Act. Legislation has been introduced in Congress to repeal Section 13b and to substitute therefor authority for the Reserve Banks, upon request of any commercial bank, to guarantee in part loans made by such bank to business enterprises.[1] If this legislation be enacted, the Federal Reserve Banks would rely upon their own surplus funds for this purpose, without resort to Government funds.

[1] A statement by Chairman Eccles to the Senate Banking and Currency Committee regarding this legislation appears on p. 521 of this BULLETIN.