net earnings to surplus until that equals one hundred percent of its subscribed capital (which is two hundred percent of the present paid in capital). After that, its net earnings go ten percent to surplus and ninety percent to the government as a franchise tax.

Larger Dividends

In recommending that reserve banks, under adequate safeguards, be permitted to declare larger dividends to member banks, there is no purpose to make the capital subscriptions of the member banks extraordinarily profitable. An increase of a full one percent in the dividend rate would increase the distribution to a bank with a capital and surplus of $100,000 by only $30. While the financial advantage of the suggested change would not be great, it is believed that it would be attractive and would be fair in principle. It would stimulate good will and, with the experience which has been gained in reserve operation, would not result in deviation from sound procedure in order merely to enlarge earnings of reserve banks. The earlier reasons for limiting dividends on stockholdings in reserve banks to six percent, such as the fear of undue emphasis upon earnings and the fear of stimulating competition by the reserve banks with their member banks, are no longer applicable. Under present law there have been years of small earnings and there is likelihood of their recurrence. No pressure to earn the dividend now permitted has been exerted. Six percent is today not as reasonable a measure of proper expectancy from such an investment as in earlier years.

Earlier Reasons for Limitation

Earnings from Competitive Operations

Future operations of the reserve system may require a larger development of the reserve banks' open-market dealings. Member banks which may meet, even to a slight extent, competition on this ground from the reserve banks have a right to share in the profits derived from such operations. Even though the monetary return to the member banks be small in amount, it is thought to be important in principle that the member banks be permitted a larger participation in the earnings of the reserve banks; such larger participation should be so devised as to permit of the amassing of ample surpluses by the reserve banks. In other words, the larger participation in earnings of reserve banks should be given to member banks principally through a proportionate reduction of the earnings now required to be paid to the federal government.

Decrease in Franchise Tax

Interest to Member Banks on Their Reserves

Permitting an increase in the dividend rate or provision for extra dividends would serve to overcome a frequent proposal that interest be paid on reserve balances, which we do not favor.

Impracticability

No method has been proposed by which interest could be safely offered by reserve banks upon member balances. At the beginning of the current year member bank reserve accounts were nearly two and a half billions of dollars. Two percent of this sum would amount to

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