

## Recapitalization of the Federal Reserve System

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The current financial crisis and the claims made on the Federal Reserve System have raised questions about the adequacy of the Federal Reserve balance sheet. Even if the liabilities of the Federal Reserve to foreign central banks (\$2 trillion) are ignored, the Fed appears to be undercapitalized relative to the tasks that we expect it to accomplish. The capital position of the Fed needs to be brought up to date to maintain global confidence in its viability.

The Treasury has \$11.041 billion of gold on its books, but it carries the gold at \$42.22 per troy ounce. At current prices, that gold is worth more than \$200 billion. The Treasury pledged the gold to the Fed years ago as initial capital, but it was deposited in the Fed in the form of gold certificates, rather than actual bullion. The certificates are valued on the books of the Fed at adjusted book value (\$11.037 billion).

If the Treasury were to put the actual gold into the Fed at book in exchange for the gold certificates, they could increase the capital base of the Fed at no budget cost. The gold could be revalued and carried on the books of the Fed at a four year moving average (currently \$638.70) of the market price (currently \$903.50). Revaluing the gold after it is transferred to the Fed would prevent the gain on revaluation from being mischaracterized as revenue in the budget. The gold injection would sharply increase the capital base of the Federal Reserve System and make it clear that Fed is still the most strongly capitalized central bank in the world. There has been some nervousness recently in both foreign and domestic financial centers about the extent to which the Fed has already leveraged its capital. The capital of the Fed would increase from the current book level of \$41.3 billion to \$167.0 billion, using the moving average approach to valuation. The Fed's total assets are currently \$996.1 billion. The gold injection or revaluation would reduce the current leverage from 24.1 times to 6.7 times, reflecting the gold revaluation in both assets and capital. It would, of course, not change the recently reduced quality of the Fed's earning assets, and it would not increase the earning power of the Fed without re-leveraging the balance sheet.

If the Fed were then able to issue interest bearing **Reserve Management Notes** denominated in US dollars in any maturity from 90 days to 20 years, they could more easily respond to any foreseeable domestic financial crisis. If they could also issue Reserve Management Notes denominated in the leading foreign currencies, subject to reasonable limits, they could hold and manage more realistic foreign exchange reserves, better support export finance, and manage our international financial balance and our

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international trade position. If they and the Treasury wished, they could neutralize currency and trade predation by other countries. If they and the Treasury wished, they could also use the international reserve management assets and liabilities to strengthen our financial links to other developed central banks, and key developing country central banks such as those of Mexico, China, India, and Brazil.

Also, if the Fed is to play a broader domestic and international role in the future, they should be permitted to retain some of their earnings, rather than paying essentially all earnings after preferred dividends to the Federal budget.

A recapitalized and modernized Federal Reserve System would be better able to respond to domestic financial needs, would be able to better balance our international payments, and to manage the balance between domestic demands and exports.

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Note: In addition to extending credit directly on their own balance sheets, the Federal Reserve Banks act as trust banks for foreign central banks and official institutions. They have recorded direct credit of \$931.340 billion. They have intermediated credit for foreign official institutions in the U.S. markets of \$2,408.855 billion. This latter total was the instrument of bubble financing for the U.S. and the world, and its deployment only in domestic markets is the reason why the U.S. international payments never balance or shift into surplus.

Federal Reserve Statistical H.4.1, September 18, 2008  
<http://www.federalreserve.gov/releases/h41/Current/h41.pdf>