C O P Y
OFFICE CORRESPONDENCE

Date January 3, 1934

TO: Mr. Wyatt

From: Mr. Smead

Subject: Retirement of Federal Reserve notes.

In accordance with your request we are giving below the principal reasons in support of the recommendation that the Federal Reserve Act be amended so as to eliminate (1) the requirement that the Federal Reserve banks maintain a redemption fund against Federal Reserve notes and (2) the prohibition against the paying out by one Federal Reserve bank of Federal Reserve notes of another Federal Reserve bank.

The prohibition against the paying out by one Federal Reserve bank of Federal Reserve notes of another Federal Reserve bank makes it necessary for each Federal Reserve bank to sort by bank of issue all Federal Reserve notes of other Federal Reserve banks received and to ship the fit notes to the issuing banks. During the year 1934 the amount of fit Federal Reserve notes so shipped to other Federal Reserve banks was $370,912,000. If Federal Reserve banks were permitted to pay out fit Federal Reserve notes of other Federal Reserve banks it would of course be unnecessary to sort these notes by banks of issue and Federal Reserve banks would also save the expense of shipping such notes to the issue banks. The annual saving would probably be in excess of $50,000. The prohibition against paying out Federal Reserve notes of other Federal Reserve banks was included in the original Federal Reserve Act and was based on a theory that such a requirement was necessary to keep the volume of Federal Reserve notes in circulation from becoming redundant. Experience has demonstrated that under the Federal Reserve System the amount of currency in circulation rises and falls daily in accordance with the requirements of the public and that no artificial restrictions on the paying out of any kind of currency are necessary or desirable. They only add to the cost of retiring the currency.

Since the discontinuance of the Agent's gold redemption fund in 1929 by the Secretary of the Treasury, the gold redemption funds of the Federal Reserve banks have served no purpose so far as the redemption of Federal Reserve notes is concerned other than to provide a fund to which the Treasury can charge unfit Federal Reserve notes received from sources other than a Federal Reserve bank. Under the present procedure unfit Federal Reserve notes of one Federal Reserve bank forwarded to the Treasury by another Federal Reserve bank are paid for through the Federal Reserve note clearing of the Gold Settlement Fund.

Unfit Federal Reserve notes received by the Treasury from sources other than a Federal Reserve bank are taken into the Treasury cash and remain a part of the Treasury cash until they have been sorted according to bank of issue when they are turned over to the Division of Issue and Redemption for verification and destruction. At the same time the bank of issue is advised by wire and the amount of the notes is charged to its redemption fund. If the redemption fund were discontinued the Treasurer of the United States could be given credit on the books of the Federal Reserve banks daily for the amount of unfit notes retired. Under the present arrangement it is necessary for the Federal Reserve banks to make transfers from time to time from the Gold Settlement Fund to their redemption funds in order to replenish them. Charges to the redemption funds made by the United States Treasurer result in the release of gold certificates to the United States Treasury which in turn deposits them periodically in the Gold Settlement Fund to the credit of one or more Federal Reserve banks in exchange for credit in the Treasurer's general account on the books of such Federal Reserve banks. It is obvious, therefore, that elimination of the redemption fund would very considerably simplify the accounting procedure in connection with redemption of unfit Federal Reserve notes received by the Treasury from sources other than a Federal Reserve bank.