

C O P Y

F E D E R A L R E S E R V E B A N K

X-1610

OF NEW YORK.

June 26, 1919.

Dear Sir:

Replying to your favor of the 19th instant, X-1586, on the subject of the transfer of certain Subtreasury functions to Federal reserve banks, I am now replying, so far as it is possible to do without an extensive investigation of this whole subject such as might unduly delay a reply, and this letter represents in general the views held by the officers of the bank.

1. We all agree that it is desirable that many of the functions now exercised by the Subtreasury in New York should be performed by the Federal Reserve Bank, and that the transfer can be effected in the near future without inconvenience either to the public or to this bank, provided certain conditions are dealt with, which are referred to later.

2. (a) Storage and Custody of Trust Funds: It is agreed in general that it will be undesirable to transfer the trust funds to the Federal reserve banks, and the method of dealing with them suggested in memorandum X-1586-a appears to be the best and most practicable, with the exception, however, of the fund of \$153,000,000, approximately, held for the redemption of United States Notes and the retirement of Treasury Notes. The gold reserve against the \$346,000,000 of United States Notes now outstanding is approximately 45%, without allowance for greenbacks which may have been destroyed and lost during the last fifty years. In our opinion, the time has arrived when legislation should be sought from Congress authorizing the Reserve banks to assume the greenbacks, retire them as rapidly as they come in for redemption and issue Federal reserve notes in place thereof. This would involve a transfer of the gold reserve.

to the Federal reserve banks, and the issue of a Government obligation to the Reserve banks for the difference between the amount of gold and amount of United States notes assumed.

This suggestion justifies stating quite fully the objects to be gained and the reasons for attempting it:

First, it will result in the consolidation and simplification of the country's currency.

Second, it will vitalize \$153,000,000 of gold which now, in fact, does not serve as reserve in our banking system, nor, since the establishment of the Reserve banks, does it serve practically any useful purpose except to exhibit to the country that a gold fund exists for the redemption of greenbacks which it is unlikely will ever be presented for gold redemption under the new conditions.

Third, it will ultimately retire the debt created during the Civil War, which in its origin certainly was unsound, and which has been a bad influence upon monetary and currency legislation ever since, and will continue to be a reminder to the public and to Congress of monetary and financial expediency of an unsound or even destructive nature.

My suggestion naturally raises the thought that if legislation in regard to the subtreasuries necessarily involves dealing with trust funds, this particular trust fund may be dealt with by the method proposed most naturally and logically because it would simply involve the substitution of one Government obligation, namely, Federal reserve notes, for another Government obligation, to wit, United States notes, behind which there is now held substantially a similar percentage of reserve. Should the argument be advanced that this was an effort by the Reserve banks to add to their gold holdings for purposes of expansion, etc., the answer is that the expansion has already taken place and this is simply recognition of its existence without

- 3 -

necessarily increasing it; but, on the other hand, giving opportunity for decreasing it because of the elastic character of our circulation, which we contract upon a fixed gold basis whenever business declines and contraction is desirable.

If this opportunity is not availed of to deal with the greenbacks, it would appear that no subsequent opportunity of as favorable a character ^{be} could be expected. It would/necessary to introduce a bill which would be greenback legislation and nothing else, whereas this will be a part of the general scheme of dealing with the subtreasuries' trust funds, etc., in a scientific manner.

The bonds to be issued by the Government should be at a suitable rate of interest offset by a tax to reduce the cost to the Government to a reasonable amount and the profit to the banks to such sum as would defray the expense of managing, printing, etc., of this large volume of small bills.

The Federal Reserve Act provides that the surplus earnings of the Reserve banks may, in the discretion of the Secretary of the Treasury, be applied to increasing the gold redemption fund behind the greenbacks, or to retiring the Government's debt. The effect of this proposal would be to consolidate those purposes, as the Secretary of the Treasury would apply the tax payment, which after this year will be quite large, to the repayment of the bonds held by the Reserve banks, having exactly similar effect to increasing the gold redemption fund.

The history of legislation amending the Federal Reserve Act and legislation of similar character since the Reserve banks were established leads me to believe that the time is opportune, and that little danger of unsound propositions is to be apprehended if the Secretary of the Treasury and the Federal Reserve Board are willing to submit definite recommendations and stand firmly behind them.

One danger to be apprehended, however, is the charge that we are eliminating from the currency the only paper in circulation which is legal tender. This is more apparent than real, because the greenbacks are now so split into small denominations that their value in a large way for legal tender purposes is very slight. I would not hesitate to offset this suggestion with the recommendation that Federal reserve notes be made legal tender, or at any rate, failing that, that they be redeemable in gold at any Federal reserve bank as, with the greenbacks retired, gold coin would hereafter be the only conveniently available currency for legal tender purposes.

The Board will doubtless observe that with this change effected in our currency the whole currency problem becomes considerably simplified. The provisions of the Federal Reserve Act for the retirement of National Bank notes, together with the almost complete retirement of gold certificates and the great reduction in the volume of silver certificates, leaves the bulk of our circulating medium Federal Reserve notes, with some hope that in time all paper currency may be consolidated into this one note issue. I shall hope that the policy of the system would contemplate, likewise, the ultimate retirement of Federal reserve^{bank} notes.

The Board's attention is called to the report of the conference of governors, dated June 11, 1917, containing, at the foot of page 8, a recommendation in regard to the retirement of greenbacks, which I believe was unanimously adopted by those at the meeting.

As to gold certificates, they are now quite generally out of circulation; they are not legal tender; and, unless the quality of Federal reserve notes in that respect is changed it appears to us quite probable that such demand as arises for gold will take the form of a demand for gold coin rather than gold certificates and that special provision for issues of gold certificates such as are called for from time to time could readily be made

in such a way that they could be issued through the Federal reserve banks.

2. (b) Distribution of Subsidiary and Minor Coins: We do not believe that any difficulty will be presented in arranging for the Reserve Bank at New York to handle the distribution of subsidiary and minor coins, which is now handled by the Subtreasury of New York, but, inasmuch as the establishment of twelve centres of distribution, in place of the subtreasuries and the Denver Mint, will somewhat change the relationship between the banks and the distributing points, it seems to us to be necessary to work out some uniform plan to cover shipping charges which will be rigidly adhered to by all the Reserve banks, as, otherwise, inequality of service might result from the change.

2. (c) Exchange of Subsidiary and Minor Coins: There would seem to be no difficulty in arranging to take over this function, and I assume that the Reserve banks will be protected, if the protection is not already afforded by existing law, against abrasion losses.

I am not sufficiently familiar with the statutes with regard to our coinage to be certain that these functions can be exercised in our capacity as depository, and I am asking Mr. Curtis to make an investigation of the statutes in this and other matters relating to the proposed change.

2. (d) Exchange of Currency: We are under the impression that the Federal Reserve Bank of New York is today handling a much larger volume of currency in its money department than has ever been handled at the Subtreasury in New York, and there will apparently be no difficulty in enlarging our organization to handle such additional business as would result from this consolidation. The custom of this bank in making shipments of unfit currency to the Treasury for redemption is substantially similar to that adopted by the Subtreasury at New York.

2. (e) Payment of checks over the counter: This matter will be

matter with the Assistant Treasurer of the United States at New York. We do not feel authorized to do so in view of the confidential character of your letter. We are under the impression that it will necessitate some changes in our present paying facilities, but nothing which can not be suitably arranged, particularly if the suggestion is adopted in regard to the Sub-treasury building hereafter mentioned.

2. (f) Costs: This heading raises the entire subject as to the relations between the Treasury and the Federal reserve banks, and I take the liberty of repeating in this letter something which I believe has already been submitted in former letters to the Federal Reserve Board or to the Secretary of the Treasury, - With the earnings of the Federal reserve banks now reaching the point where large payments of excess earnings will shortly be made to the Treasury Department, there will be constantly presented the temptation to enlarge the functions and services of the Reserve banks both for the Treasury Department and for the member banks, and we are most anxious that at no time the charge can be made that the revenues of the Reserve banks are used in such a way as to escape the necessity of going to Congress for appropriations. In general we think the principle should be adopted that the Federal reserve banks should be reimbursed for the expenses involved in performing their functions as fiscal agents, possibly even that a basis of compensation should be arrived at, the effect of which would be simply to swell the profits of the Reserve banks, which, in turn, would result in a greater payment to the Treasury, so that the principle underlying all the financial affairs of the Government would apply to the reserve banks, viz., that no money may be paid out of the general fund of the United States except under authority of an appropriation act by Congress. The argument that the cost of the Subtreasury system is only \$500,000 per annum, which can be absorbed out of the profits of the Reserve banks, strikes us generally as contemplating a violation of a

principle which is so fundamental in our Government as to give occasion for grave doubt.

2. (g) Fiscal Agents: This topic raises a legal question of great significance to the Reserve banks and to the Treasury. As depositaries of the general fund of the Government, our relations are those recognized legally as that of debtor and creditor and, as such, our powers are limited and our functions as an agent practically nil. As soon as the Reserve banks assume duties such as those contemplated by the transfer of the business now conducted by the subtreasuries, it makes little difference whether the banks are regarded as performing those functions as depositaries or as fiscal agents, the facts would probably be found to control, namely, that we were acting as fiscal agents and that our duties and responsibilities and liabilities would be determined by that actual relationship rather than by an assumed relationship of debtor and creditor.

In general, it seems that the Federal reserve banks are able to perform these duties as fiscal agents just as capably, and with just as little liability of loss or inconvenience to the Government as are the Government's own officials, i. e., Assistant Treasurers at the Subtreasuries, and our inclination now is to strongly recommend that any distinction in legal relationship between that of debtor and creditor and depositary be made perfectly clear and it be understood that we are not assuming to perform fiscal agency duties as depositaries and endeavoring to create a fiction which would not stand the test of the courts.

2. (h) Subtreasury Buildings: The subtreasury building in New York is a monument of national importance. We would very much regret, and believe the people of this city would resist, any effort either to do away with the building or to transfer it to some other service of the

Government than that having to do with the operations of the Treasury Department. The entire building needs remodeling inside, and new vaults should be constructed. Our suggestion would be that, temporarily, when the transfer is effected, this building be turned over to the Reserve bank for the conduct of the business which can readily be housed in that building, with provision to be made in our new building for a temporary transfer of the business now done in the subtreasury pending the construction of new vaults and the rearrangement of the interior, and, when both our new building and the subtreasury building are completed and remodeled, the subtreasury building be used by the Reserve bank permanently for such departments of the bank, - principally, I believe, the money and coin departments, - as can be conveniently handled there and as will best serve the needs of the banking community in that congested area. If that were done, it would be very simple to have the clearings effected in that building should arrangements ever be effected with the clearing house to have the clearings take place at the Reserve bank.

2. (1) Compensation: Should the suggestions under the heading "Costs" and in the last paragraph, appear to be feasible, I am under the impression that an arrangement could readily be worked out by which the subtreasury would remain the property of the United States, to be used by the Reserve bank at a fair rental, and the payment of rental to be considerably offset by an allowance of expenses and compensation in conducting the work of the Treasury.

X-1610

- 9 -

In conclusion, I hope that no legislation is undertaken along the line of the suggestion contained in the memorandum accompanying your letter without a very thorough study of all the statutes of the United States bearing on this matter. If the change is to be effected, I should hope that it would be thorough going and take place after a sufficient lapse of time to enable us to effect the change without any inconvenience to any of the interested parties,

Very truly yours,

(Signed) BENJ. STRONG

Governor.

Honorable W. P. G. Harding,
Governor, Federal Reserve Board,
Washington, D. C.