

Fiftieth Anniversary of the Federal Reserve System*

NAMING OF RESERVE BANKS AS TREASURY DEPOSITORIES AND FISCAL AGENTS

The authors of the Federal Reserve Act were aware that the methods employed in managing the Treasury's finances had serious defects. Many of the Government's fiscal affairs were handled by the Independent Treasury System, which had been established in 1846 to provide places other than private banks for the safekeeping of Government funds. The defects of that system had been described in a study published by the National Monetary Commission.

Most of the Treasury's revenues from customs and taxes were collected in currency and coin, and it was Treasury practice during most of the pre-World War I period to hold this money in the subtreasury offices located around the country until it was needed for disbursements. Hence, when Treasury receipts exceeded disbursements and the surplus was held in the subtreasury vaults, money in circulation declined. Since currency and coin were also an important component of bank reserves, its withdrawal from the banks contracted the reserve base, and there was no central banking mechanism through which this effect could have been offset at times when reserve withdrawals were inappropriate in the light of current economic developments.

Successive Secretaries of the Treasury had attempted on occasion to relieve undesirable contractions of the bank reserve base by transferring funds from the subtreasury to the national banks, which had been used as depositories since the passage of the National Banking Act. These attempts were only partially successful. The establishment of the Federal Reserve System itself was, of course, a major step in combating this and other inflexibilities in the country's money and banking structure.

An early version of the Federal Reserve bill required that all general funds of the Treasury be deposited in the Federal Reserve Banks within twelve months after passage of the act. This provision was successfully opposed by

Secretary of the Treasury McAdoo as being too rigid. Thus, the final version of the bill left the amount and timing of the transfer of funds up to the discretion of the Secretary of the Treasury, thereby permitting him to continue using the subtreasuries and national banks as depositories. This earlier draft of the bill also appointed the Federal Reserve Banks as fiscal agents, whereas the final act authorized the Secretary of the Treasury to require the Banks to act as fiscal agents at his discretion. In actual fact, the Secretary of the Treasury began using the new Reserve Banks as depositories in 1915 and as fiscal agents in January 1916.

At first, the fiscal services performed by the Reserve Banks were limited to receiving deposits of Government collectors of customs and internal revenue and to paying checks and warrants drawn upon the United States Treasury. However, after the United States entered World War I, Secretary McAdoo turned to the Reserve Banks for other services. In particular, the Banks were authorized to sell, issue, exchange, and convert Liberty bonds, and they became the focal points for local Liberty Loan committees, which made a vital contribution to the financing of the war.

Another useful service performed by the Federal Reserve Banks was the transfer of money around the country by wire and bookkeeping entries. This procedure—made possible through the deposit of gold and gold certificates by each Reserve Bank in the gold settlement fund in Washington—eliminated the necessity for expensive shipments of coin and currency between subtreasuries.

It soon became evident that the Reserve System could perform many of the fiscal agency functions at least as efficiently as subtreasuries, and that having both was an unnecessary expense. In May 1920, therefore, Congress passed a bill directing the discontinuance of the nine subtreasuries on or before July 1, 1921. The Secretary of the Treasury proceeded to carry out this task by transferring many of the remaining fiscal agency functions from the subtreasuries to the Reserve Banks. The last subtreasury, located in Cincinnati, was closed on February 10, 1921.

* The tenth in a series of historical vignettes appearing during the System's anniversary year.