

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

June 17, 1926.

My dear Mr. Hamlin:

Your letter of June 10th was duly received and I am glad to know that, before any change is made as to the existing Federal reserve bank agencies in Cuba, this bank will be given an opportunity to be heard. I note also that you are inclined to think that it will be some little time before the matter is taken up by the Board. The subject was discussed informally at our Directors' meeting yesterday, but no action looking to a change in our present status was taken.

You suggested in your letter that if any further plan occurred to me for working out this problem, that I advise you. My personal view is that a Federal reserve agency in Cuba is not justified for the purpose merely of providing the people of Cuba with currency fit for circulation which I think is an obligation of the Cuban Government itself. By paying transportation charges on unfit notes to Washington and on new currency which is to replace the unfit notes, the Cuban Government could keep the currency in circulation throughout the island in a reasonably fit condition, and at a cost no greater than it would incur should it engrave and print its own bills. In fact, I understand that the Cuban treasury has already expressed a willingness to bear one-half of this expense. Nor do I think that an agency in Havana is justified for the purpose of enabling any Federal reserve bank to keep in circulation in Cuba a large volume of its Federal reserve notes. Indeed I think there are certain vital objections to this which will be discussed later on in this letter.

I think, however, that a Federal reserve agency in Cuba is justified upon the ground that the United States government by virtue of the so-called Platt amendment has entered into relations with Cuba which it does not have with any other foreign country, especially in matters of finance and currency, all United States currency having been made legal tender by act of the Cuban Congress, and for the additional reason that in the year 1923, the President of the United States and the Department of State advised the Federal Reserve Board that it was important that a Federal reserve agency should be established in Cuba. By limiting the functions of the agency to the purchase of bills of exchange and to the purchase and sale of cable transfers, which transactions are authorized in section 14 of the Act, exchange rates in Cuba would be stabilized and should sufficient currency be kept on hand by the agency, the banks in Havana which include branches of three member banks of the Federal

Reserve System would be enabled to render more efficient and economical service to the public and with greater safety to all concerned. In this connection, it is well to consider the large investments by Americans in Cuba, the amount of which is variously estimated at from one billion to one billion five hundred million dollars.

About 3 years ago, the Federal Reserve Bank of Boston made application to the Federal Reserve Board for permission to establish an agency in Havana for the purpose of buying bills of exchange and of buying and selling cable transfers. This application was not made with a view of circulating Federal reserve notes in Cuba. While this application was being considered by the Board, the Federal Reserve Bank of Atlanta also applied for permission to establish an agency primarily for the purpose of maintaining the circulation of its Federal reserve notes in Cuba and the Board on July 30, 1923, adopted a resolution establishing two agencies, the effect of which has been that purchases and sales of cable transfers have been made by the Federal Reserve Bank of Boston which bank has received the direct profits resulting therefrom, while the receipts and disbursements of currency involved in these transactions have been handled by the Federal Reserve Bank of Atlanta and at its own expense, without any direct profit although it has thereby been enabled to maintain and possibly to increase its circulation in Cuba.

The delays experienced by this bank in completing cable transfers on the occasion of the run on many of the banks in Havana beginning April 9, 1926, when transfers aggregating \$39,200,000 were requested of this bank and could not be completed promptly (some transfers requested on Saturday, April 10, were not completed until Wednesday, April 14) because the Havana Agency of the Federal Reserve Bank of Atlanta had on Saturday, April 10, less than \$7,500,000 in currency on hand, calls for consideration of the question whether the two separate reserve bank agencies in Havana should be continued.

The agencies of the Federal Reserve Banks of Atlanta and of Boston exist for a service which either agency alone might render but since one agency undertakes the initial part of each transaction and the other attends to its completion in the receipt or delivery of its equivalent in cash, neither agency has the ability to furnish the complete service and neither has entire responsibility for the proper performance of agency functions. The dual organizations are therefore necessarily cumbersome and unnecessarily expensive for the usual course of business and the absence of a common control or direction of the service which they share militates against their meeting promptly and efficiently emergencies such as the run commencing on April 9, which though in fact handled successfully, could not have been met without the assistance which the representative of this bank was able to obtain from the Cuban government, assistance which was available solely because the Cuban treasury at the moment happened to be able and to be disposed to render it, but which might not be available on another occasion however helpful might be the disposition of the Cuban officials.

Considerations of efficiency and of respect for the favorable opinion of banks and business houses which would undoubtedly hold both agencies responsible for a failure of services such as that which impended on April 9, suggest that one of the two agencies be discontinued; and though the initiative in the establishment of an Havana agency for dealing in cable transfers was taken by this bank and though its agency has been conducted in such a way as to yield a substantial net profit and to receive the good will and commendation both of Havana banks and of the Cuban government, especially during the emergency beginning April 9, I believe, in the interests of trade relations with Cuba and of the Federal Reserve System as a whole, that if the Federal Reserve Board should not be disposed to consolidate the two agencies under the direction and control of the Federal Reserve Bank of Boston, the agency of this bank in Havana should be discontinued.

So far as concerns the service contemplated in this bank's original application for an agency in Havana, experience has demonstrated that a single agency can perform that service more efficiently than two agencies with a division of functions and of responsibility. While it is true that the agency earnings of this bank have been considerable, earnings alone without any consideration of service do not constitute a sufficient reason for the continuance of the two agencies.

Aside from the practical difficulties of effecting cable transfers through two separate agencies, the possibility of serious liability arising out of the paying agency's inability to complete transfers should be borne in mind. In emergencies like the one beginning on April 9, two courses might be open to the first reserve bank, that is, the bank receiving requests for transfers which there is reason to believe the agency of the second or paying reserve bank, may be unable to pay promptly. The first of these courses would be for the reserve bank to decline to receive the requests at all. But even assuming that the reserve bank would be strictly within its legal rights in so doing, and could so decline without incurring liabilities similar to those which might attach for example to a refusal by a common carrier to serve anyone complying with its published tariffs, the availability of this course would be largely theoretical. Absolute declination of service while any possibility of accomplishment exists, would be unthinkable in any crisis involving such consequences of financial disaster as the one in Cuba in April, and though probably under no legal compulsion to accept without condition orders for cable transfers, the reserve bank in view of its inauguration of this service and its peculiar relation to other banks which have come to rely on this service, would be subject to severe condemnation were it to refuse service unconditionally, and would be under a strong moral obligation at least to undertake the service on some basis. As a practical matter, therefore, only one course is open to the first reserve bank, namely, to accept the order and seek to protect itself by stipulation that the transfer is undertaken without guarantee of completion and subject to the ability and readiness of the second reserve bank to make payment.

This course, conditional acceptance, can not be considered free from peril, and liabilities for damages resulting from failure to complete transfers might be entailed if for any reason the conditions which the reserve bank sought to impose could not be established as having been accepted by the other contracting party, or if for any reason the failure of service was not within the scope of those conditions. A state of rush and more or less confusion nearly always characterizes important crises such as the Havana run, orders are given and accepted by telephone and as a rule through the intervention of another Federal reserve bank, and even though confirmed by telegrams and letters as required, it might in some important cases be difficult to establish definite acceptance of the conditions by the bank asking for ^{the} transfer and without such acceptance, the stage may be set for serious loss or at least for litigation when it would probably be found that the conditions invoked as a defense for failure of service, if established, would be construed strictly against the contracting reserve bank.

In connection with possible action by the Federal Reserve Board authorizing a single agency in Havana, and in conformity with Section 14(e) of the Federal Reserve Act which provides that whenever a foreign agency has been established by a Federal reserve bank "any other Federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the Federal Reserve Bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the Board," it seems to me that the Federal Reserve Board should permit any Federal reserve bank which cares to do so to share in the facilities, the earnings and the expenses of conducting the single agency as is now the practice with regard to foreign bank accounts carried with the Federal Reserve Bank of New York.

It is my opinion also that the Federal Reserve Board should require the agency to confine its cash disbursements to gold and silver coin, gold certificates, silver certificates, United States notes and National bank notes, and that no Federal reserve notes issued by any Federal reserve bank should be paid out by the agency. If such a course were followed, it would mean that when the agency received Federal reserve notes it would return them in the usual course of business to the United States for redemption, which would bring about a gradual retirement of Federal reserve notes now in circulation. At this time this would cause no embarrassment to any bank having such circulation. It is obvious that in the case of Federal reserve notes circulating in a foreign country, the redemption of such notes is greatly impeded, however easy and frequent communication with that country may be, and while the circulation of Federal reserve notes in foreign countries may not at all times be open to the same objections as excessive bank note circulation within the United States, it is evident from the history and provisions of the Federal Reserve Act, which originally permitted the issue of such notes against rediscounted paper only, and particularly from the provisions of the act with reference to issue and redemption and the penalty against one Federal reserve bank paying out notes issued by another

Federal reserve bank, that the circulation of Federal reserve notes in any considerable volume in foreign countries was not contemplated by the Act. Such circulation, artificially stimulated and maintained by any reserve bank, and bearing no relation to the requirements of commerce and industry in its own district is inflationary; and in the case of Cuba it is entirely possible that Federal reserve notes circulating there might at some future period be returned for redemption at a time when it might be very inconvenient for the issuing bank to redeem them. Furthermore, it should be borne in mind that the so called War amendments (Acts of September 7, 1916 and June 21, 1917) which authorize the issuance of Federal reserve notes against gold or against bills purchased in the open market plus the gold reserve, have been under criticism in certain quarters for some time past upon the theory that they encourage inflation. Any continued artificial circulation of Federal reserve notes in foreign countries is likely to be used as an argument for the repeal of these amendments which, under a proper construction, are useful and salutary.

The sixth paragraph of the preamble to the Board's resolution of July 30, 1923, reads as follows:

"Whereas, a substantial portion of the currency now in circulation in Cuba consists of Federal reserve notes of the Federal Reserve Bank of Atlanta; and it is feared that the establishment of an agency of another Federal reserve bank in Cuba might result in the retirement of such notes from circulation; and the Federal Reserve Bank of Atlanta desires to establish an agency in Cuba primarily in order that it may maintain the circulation of its Federal reserve notes in Cuba;"

Should the bill which Mr. McFadden introduced near the end of the final session of the last Congress be re-introduced at some future time, the advocates of such a bill could point to this as a horrible example of the effect of the amendments to which reference has been made above, and I sincerely hope that when the Federal Reserve Board has reached a conclusion in the Cuban agency matter, the preamble and resolutions then adopted will at least contain no reference to the use of an agency as a means of enabling any bank to maintain the circulation of its notes in that country.

I expect to be in Washington on Monday to attend the meeting of the Open Market Investment Committee, and hope to have an opportunity of talking with you further on this subject.

Very truly yours,

(Signed) W. P. G. Harding

Governor

Hon. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.