TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE 1/11/43

TO Mr. Morgenthau

FROM Mr. Callahan

Attached are our two latest newspaper advertisements.

WHAT'S THIS WAR ABOUT, DADDY?

Honey, in a place called China, children can never play as you can . . . because men in airplanes roar overhead and shoot them, and burn their homes.

In other places . . . in Norway and France, in Poland and Greece and Russia . . . children have their mothers and daddies taken away from them . . . led off to a prison called a concentration camp. Their children may never see their parents again.

Many of these children—boys and girls just like you—don't get enough to eat. Many of them have starved to death.

Why is all this happening? Because there are evil people in the world, who call themselves the Axis, who do these things. And it's our job to make them stop—to see that they never trouble the world again. *That's* what this war is all about.

To do our job we've got to knock out the Axis. And a lot of us Daddies would like to do it with our own fists . . . or our own guns. We can't all do that. There's other work that Uncle Sam wants us to do.

So let's help knock out the Axis with that work. Let's take a dime out of each dollar we earn while working and buy War Bonds and Stamps to turn our dollars into America's tough new tanks and planes.

So . . . tell your employer to set aside 10 percent of what you earn every payday in the War Bond Payroll Savings Plan. Then, each time it adds up to $18.75, you'll get a bond.

Your Government will use that money to smash the Axis. Every dollar is a nail in Hitler's coffin. Every bond a bomb to blow the Jap off this earth. And your money is an investment against that time when peace returns and you will no longer have to answer that question:

"Daddy, what's this war about?"

EVERYBODY EVERY PAYDAY 10%

WHY U. S. WAR BONDS ARE THE SAFEST PLACE YOU CAN PUT YOUR MONEY!

1. They are obligations of the United States. If this isn't safe, nothing is!
2. For every $3.00 you invest in War Bonds you get back $4.00 at the end of 10 years.
3. They do not fluctuate in dollar value—are never worth less than you pay for them.
4. You can name one individual either as co-owner or as beneficiary *right on the face of the bond.*
5. Your savings in War Bonds cannot be lost or stolen. Each bond is *registered at the Treasury Department.*

EVERYBODY—EVERY PAYDAY 10% IN WAR BONDS

THIS ADVERTISEMENT IS A CONTRIBUTION OF (YOUR NAME HERE) TO AMERICA'S ALL-OUT WAR EFFORT

Men you've never even met
Are fighting for you now!

Americans, all—millions of them!

The son of the tailor down at the corner . . . the young brother of the banker . . . the nephew of the gas-station man . . . the farm boy from Iowa . . . the college boy from Park Avenue.

Fighting, all of them—*for us*. That's Democracy in action. Because all Americans were "created free and equal" every American has an equal duty to perform.

And that's where WE come in. We've got to *back up* those boys. We've got to see that they get the stuff to fight with. Planes . . . tanks . . . guns . . . bullets . . . bombs . . . more of them than the world has ever seen before.

Every payday we've got to *save*—put 10 percent of our pay in War Bonds. Millions of other Americans are doing it. "Sacrifice," you say? *As great a sacrifice as the boys made at Bataan or Corregidor!* As great a sacrifice as a flier made who deliberately gave his life to bomb a Jap plane carrier!

Nothing we can do can ever equal what these men have *already* done!

Mind you, we're not even asked to give this money. Every time we save $18.75 we get a War Bond worth $25 in 10 years.

That's why we're not looking for excuses, we Americans. We're not looking for excuses from *lending* money, when other Americans are *giving* their lives!

DO YOU KNOW?

When you buy WAR BONDS, you're saving, not giving! Series E WAR BONDS are worth 33⅓ percent more in 10 years! You get $4 for every $3 you invest!

These BONDS, when held to maturity (10 years), yield 2.9 percent per year on your investment, compounded semiannually!

Joining a Pay-Roll Savings Plan makes saving easy!

Joining your bank's Victory Club (it works like any Thrift or Christmas Club) is a convenient way to save for War Bonds for those who aren't members of a Pay-Roll Savings Plan.

You can have enough money to do a lot of things you'd like to do, and to buy the many things you'll need after the war is over, if you save enough in War Bonds every payday NOW!

You can start buying WAR BONDS by buying War Stamps for as little as 10 cents.

EVERYBODY EVERY PAYDAY 10%

EVERYBODY—EVERY PAYDAY 10% IN WAR BONDS

This Advertisement Sponsored in Honor of (Name of City)'s (Number) Fighting Men by

YOUR NAME HERE

494808

123

January 11, 1943.

Dear Mr. Berlin:

Your letter of December 31 was received here during the Secretary's absence from the office because of illness. Just as soon as he is back at his desk, I shall be very glad to bring the letter to his attention.

Sincerely yours,

(Signed) H. S. Klotz

H. S. Klotz,
Private Secretary.

Mr. Irving Berlin,
799 Seventh Avenue,
New York, New York.

GEF/dbs

IRVING BERLIN

December 31, 1942

My dear Mr. Morgenthau:

I received your note with a copy of the Australian version of "Any Bonds Today". Many thanks for sending it to me. I think it's swell, and I need not tell you how happy it makes me to know that Australia thought it good enough to use as their song, too. I think their version is fine.

We keep going on our merry way with the show, and while it is a tough job, the amount of good we are doing and the satisfaction I am getting personally out of it, more than makes up for it. We play Chicago for two weeks after we leave Detroit on Sunday, and then go to the Coast to make the picture. Our road tour and the twelve weeks in New York will result in about $1,750,000.00 for our fund, and with the motion picutre, we should easily earn five million dollars. I realize with the kind of figures that you deal in, five million is just a drop in the bucket, but it's pretty good for a show. All this, of course, is small compared to the job of civilian morale which everyone seems to think we are doing.

I have volunteered all the above because I know how interested you are in this work.

With my best wishes to you and your family for a Happy New Year, I am

Sincerely,

Irving Berlin

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

CONFIDENTIAL

DATE January 11, 1943

TO Secretary Morgenthau

FROM Mr. Haas

Subject: The Business Situation,
Week ending January 9, 1943.

Summary

Wholesale prices: Featured by strength in farm products and foods, basic commodity prices continued to move higher last week. The BLS index of basic commodity prices advanced 0.5 percent to another new peak, while Moody's index of spot prices reached the highest level since March 1929.

National income: Payments in November, according to data just released, rose to an annual rate of $124.9 billions as compared with $121.2 (revised) in October and $98.3 billions in November 1941. Payments for salaries and wages were at a new high, 32 percent above the corresponding period last year.

Dividend payments: Cash dividend payments in 1942 dropped 18 percent below 1941 levels to $3.6 billions. The decline was partly due to substantial payments on preferred stock arrears in the earlier period.

Retail food prices: The BLS index of retail food prices rose 1.2 percent further in the month ended December 15. Since August 1939 the U. S. index of retail food prices has risen 41.9 percent while the Canadian food price index in approximately the same period rose 33.7 percent.

Civilian goods: Production of civilian goods in 1943 is expected by WPB to decline from 15 percent to 20 percent although the drop in goods available is likely to range from 10 percent to 15 percent due to existing inventories. Sales of consumers' durable goods are expected to show a further decline of about 35 percent as compared with a drop of about 15 percent in non-durable goods.

Steel production: Output in 1942 reached a new record high of 88 million net tons--an increase of more than 3 million net tons above 1941 levels. Steel ingot production in December fell about 125,000 tons short of weekly operating schedules due to floods and holiday interruptions.

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Accelerated price rise continues

Under the continued leadership of farm and food products, wholesale commodity prices last week again rose to new high levels. Moody's index of spot prices rose 1.2 percent to a new peak, and the Dow-Jones futures index also made a new high, exceeding its earlier highest point reached in January 1942. (See Chart 1.) Prices of staple commodities moved sharply upward. An abrupt rise in the BLS index of 9 uncontrolled commodities lifted this index to a new high for the sixth consecutive week.

The advance apparently is due to:

(1) Continuous reports of an aggressive congressional program to ensure greater returns to the farmer;

(2) Public recognition that food and fuel prices are being allowed to rise;

(3) A widespread opinion that controls over prices in many categories will be relaxed further "in order to encourage production"; and

(4) Heavy Government purchases for current domestic and foreign needs, attended by a growing belief that post-war requirements for both will be in great volume.

National income payments at new high

National income payments, after allowance for seasonal factors, showed another sharp gain in November and attained an annual rate of $124.9 billions, according to data just made available. This record figure compares with an annual rate of $121.2 (revised) in October, and $98.3 billions in November 1941 just before our entry into the war. (See Chart 2.)

Coincident with the release of income data for November, the Department of Commerce also disclosed a revision of monthly income payment figures back to the beginning of 1941, principally to allow for recent revisions of employment and payrolls indexes by the Bureau of Labor Statistics. The effect of this revision is to raise monthly income payments since last March to even higher levels. Thus the October annual rate of payments as revised is $3.3 billions higher than previously reported.

Payments for salaries and wages continued to expand in November and were 32 percent larger than a year earlier. Moreover, they comprised 71 percent of total income payments during the month, as compared with 69 percent in November last year. Due to seasonal factors, agricultural payments receded from the October peak. However, cash income from farm marketings and Government payments was 43 percent above that of November 1941.

Dividend payments decline

In contrast to the gains shown by other major income groups, interest and dividend payments continued to lag behind 1941 levels. Preliminary data for the entire 1942 year reveal that interest and dividend payments fell 5 percent below the previous year. Cash dividend payments alone last year dropped 12 percent below 1941 levels, and totaled about $3.6 billions.

This decline in dividends, however, does not represent a reduction in net income after taxes. The heavier dividend payments in the previous year were partly due to substantial clearing up in arrearages, while some dividend reductions in 1942 reflected provisions for war plant expansion and contingencies, as well as the retarding effects of conversion to war work. Thus in the automotive field General Motors paid $2 per share in 1942 as compared with $3.75 in 1941, while Chrysler paid only $3.50 as compared with $6 in the earlier period. The General Motors reduction alone cut dividend payments by $76 millions.

Although the continued rise in the annual rate of income payments was accompanied by a further increase in the cost of living in November, reference to Chart 2 will disclose that income payments continued to climb at a more rapid pace than living costs. Thus if income payments are expressed in August 1939 dollars, by dividing by the BLS cost-of-living index (August 1939=100), to allow roughly for the decline in the domestic purchasing power of the dollar, income payments in November were still about one-sixth larger than a year earlier.

United States food costs in sharper rise than Canadian

As foreshadowed by steeply rising farm prices and by ceiling price increases allowed by the OPA, retail food prices in the United States continue to increase steeply. In the

month ended December 15, according to the BLS index, retail food prices rose 1.2 percent, the same large increase as in the previous month. This indicates another substantial advance in the composite cost-of-living index which will be released later. (See Chart 3, lower section.) In contrast, the rise in Canadian food costs during November slackened to 0.3 percent from a rate of 2.0 percent in October.

The Canadian food index as of December 1 has risen 33.7 percent since August 1939, as compared with a rise of 41.9 percent in the United States food index. As usual, the Canadian cost-of-living index chiefly reflected the change in food costs, hence the rise in total living costs tapered off from an advance of 0.7 percent in October to 0.2 percent in November.

Despite passage of the emergency price control act early in 1942 and subsequent price measures, which put food prices under partial control, the net rise in the BLS food index in 1942 (from December to December) was greater than in 1941, amounting to 17.3 percent as compared with 16.2 percent in 1941. The rise in the Canadian food index in 1942 was only a little more than half as great as in 1941.

The BLS cost-of-living index advanced practically as much during 1942 as during 1941, rising approximately 9.3 percent as compared with 9.8 percent in 1941. The Canadian cost-of-living index (based on December 1 figures) rose only 2.6 percent in the 1942 period, as against 7.2 percent in 1941.

Large price increases for uncontrolled foods

Although retail food prices on the average rose 4.8 percent in the 3-month period between September and December, prices of many foods in common use advanced a great deal more. This was particularly true of fresh vegetables and fruits, which are largely exempt from price control. Part of the price increases for these items have doubtless been due to seasonal factors.

Retail price changes in the 3-month period September to December are shown in the attached Table 1, covering the individual foods in the BLS food price index. In the second column (as a rough measure of the normal price movement due to seasonal factors) price changes are shown for the same three months in 1940, when the food index as a whole showed practically no movement. The large price increases recently for various fruits and vegetables, in comparison with the seasonal tendency,

will be particularly noted. On the other hand, price control has evidently operated to stabilize prices of certain important foods, such as butter.

Basic commodity prices continue upward

The BLS price index of 28 basic commodities continued to rise last week, with the index on Saturday showing a gain of 0.5 percent over the previous Saturday, despite the fact that two-thirds of the commodities in the index are under price control. (See Chart 4, upper section.)

The index of 9 uncontrolled commodities (actually 8, since butter is now also under control) made an especially sharp gain, with 7 of the commodities strongly higher. (Lower section of Chart 4.)

OPA acts to standardize retail food pricing

A move toward accomplishment of the recently-announced OPA policy of standardizing food pricing at the retail level has been taken with the establishment of new and uniform margins soon to be put into effect on nine food commodities for wholesalers and retailers. Each dealer will apply the uniform markups to his net cost to calculate his dollar and cents maximums. Little if any difference in the cost of living will be made by this action, according to the OPA, because of offsetting changes.

In addition, new maximum price ceilings have been ordered effective January 14 on retail sales of butter, fresh citrus fruits, bananas, cheese, and poultry. The regulation setting these new ceilings also substitutes fixed marginal markups for the ceilings previously based upon the highest prices charged in a specified period. In this instance the OPA has stated that the new ceilings will result in somewhat lower prices for bananas, practically unchanged prices for butter and cheese, but slight advances for poultry and for citrus fruits.

Another increase in the price of fuel was authorized by the OPA when an advance of approximately 50 cents a ton was allowed on Pennsylvania anthracite coal. The new price increases, effective January 9 at both mine and retail levels, will average about 5 percent. According to the announcement, the increase "reflected higher production costs involving the extension of the 35-hour week to six days" (7 hours being added at overtime rates), and other cost increases to the industry.

A press report states that the OPA plans to publish in each town the price that can be charged by the highest price outlet for each food item. This would be an important step to help the consumer tell whether or not he is being charged prices above or below ceilings.

Developments in prices of staple commodities

Further complaints of the inadequacy of recent OPA action in raising flour prices are heard from both millers and bakers. Millers say that the OPA apparently took no account of an average advance of 15 cents a bushel in soft winter wheat prices between the base period and the present. When the short crop this year in central states left millers of soft wheat in many areas with little or no free wheat to purchase, the CCC promised to make soft wheat available from their stocks. Apparently, however, the CCC has no great amount of wheat of this variety.

Evidently in an attempt to alleviate the situation, the AAA has asked local committees to point out to farmers that loan wheat may now be marketed at a substantial profit. This applies to resealed 1941 farm-stored wheat and to the 1942 crop. The AAA suggests further that moving of farm-stored wheat now will avert a tight storage situation next spring. Meanwhile, wheat prices advanced more than 3 cents last week to new 5-year highs.

As the OPA began widespread investigation into reported evasions on meat and poultry, evidences of further disparity between meat ceilings and livestock prices became apparent. The American Meat Institute charged that abnormal demand for beef cattle, with present inadequate supplies of cattle, have raised cattle prices to a point higher than justified by ceiling prices for dressed beef. Slaughter of cattle and calves last week, for the sixth successive week, was below that in the corresponding period a year ago.

Another squeeze in pork prices

A recurrence of last summer's squeeze between hog and pork prices may be indicated by a continuance of less than anticipated hog receipts. In the last two weeks, packers' gross margins (as indicated by the Department of Agriculture figures) have been at an unprofitable level. (See Chart 5.) The lower level of pork prices since early November reflects revised ceilings placed on pork products.

In only two weeks since September have hog receipts been commensurate with supplies on farms, and in the last three weeks they have been far below. Although unfavorable weather recently has contributed to the failure to market more hogs, the chief factor has been a desire of farmers to feed their hogs to heavier weights. Prices for hogs last week advanced to their highest levels since early October.

Milk prices raised

The Pennsylvania Milk Control Commission, with OPA approval, last week increased the price of home-delivered milk from 14 cents to 15½ cents a quart. Store milk was increased to 15 cents.

In comment upon Secretary Wickard's request for "elimination of frills", the President of the Dairymen's League Cooperative Association in New York called for an overhauling of New York City's extravagant delivery system. He stated that little or nothing has been done to wipe out duplication and waste, contending that New York City's 47 milk plants have a capacity 25 percent greater than necessary, and that fluid milk is hauled 300 to 400 miles to the city while milk within 250 miles is manufactured.

Continued heavy demand for butter by the Government was disclosed by Secretary Wickard's recent order that manufacturers of creamery butter must set aside 30 percent of their monthly production for direct war requirements beginning February 1. It is expected that more than two-thirds of the butter set aside will go to our military forces, and the balance will go almost entirely to Russia. The announcement pointed out that operation of the order becomes effective at the time production usually begins its rise toward the seasonal May-June peak.

Margarine production in November, it has just been announced, was the largest for any month on record. Colored margarine amounted to 17 percent of the total, in contrast to less than 1 percent in the November 5-year average. A measure to increase the supply of edible oils and fats was taken by the WPB last week in an order completely prohibiting the use of edible fats and oils in the manufacture of inedible products for civilian use.

Farm organizations call for longer industrial work-week

In a joint statement of farm policy, leaders of four national farm organizations have called upon the new Congress to raise farm product prices and increase the present industrial

Preliminary estimates of actual steel ingot capacity at the end of the year center around 91 million net tons. The considerable progress made by the industry in meeting the extremely critical need for steel plates is demonstrated by the fact that plate production in 1942 was stepped up to 11.8 million net tons from 6 million in 1941.

Need for railroad materials stressed

With the gasoline shortage in the Eastern states throwing further burdens on the railroads, additional attention is focused on their material and equipment needs. In its annual report to Congress last week the Interstate Commerce Commission stated that "unless there can be allocations of sufficient material to the railroad transportation agencies to permit them to maintain, renew and operate their plants, so that they may continue their present standards of service, more restrictive Government control of the use of transportation services will follow".

Total transportation volume of all categories in 1942 is calculated to have risen 28 percent above 1941 levels, with commodity traffic gaining 25 percent and passenger traffic 45 percent. Further freight traffic gains of from 10 to 15 percent are being forecast for 1943, and nearly all indications point toward further extreme pressure on passenger transportation facilities.

Some appreciation of the greatly increased freight traffic burden of the railroads and the more effective utilization of equipment will be seen by referring to Chart 6. It will be noted that in October, the latest month for which ton-mile figures are available, freight traffic jumped to a new high 29 percent above the 1941 peak, despite the fact that carloadings were down moderately from the previous month and were only 4 percent above the corresponding month in 1941.

Table 1

Price changes for individual food products in BLS retail food price index

Commodity	Percent change December 1942 over September 1942	Percent change December 1940 over September 1940	Weight in food index 1/
Carrots	53.6	9.8	.9
Beans, green	46.6	23.4	.6
Lettuce	28.0	2.4	1.7
Cabbage	17.9	0.0	.7
Spinach	16.8	-11.4	.9
Apples	14.5	6.4	1.5
Oranges	12.5	- 7.9	3.7
Onions	11.1	- 2.8	.9
Lard	8.7	- 1.1	.9
Butter	8.3	21.9	5.1
Prunes	8.1	- 1.0	.6
Potatoes	7.5	0.3	3.2
Eggs	7.4	7.0	5.9
Peanut butter	7.2	- 0.6	.2
Bananas	6.8	3.1	1.4
Peaches, canned	5.4	- 1.2	.5
Cheese	5.2	3.5	1.5
Corn meal	4.0	2.4	.3
Corn, canned	3.8	1.0	.6
Milk, evaporated	3.4	0.0	1.0
Tomatoes, canned	3.4	- 1.2	1.5
Pineapple, canned	2.8	0.0	.4
Bacon, sliced	2.4	4.7	1.6
Flour, wheat	2.4	3.0	1.7
Lamb, leg	2.4	- 9.6	1.3
Salmon, pink	2.3	0.0	.6
Chickens, roasting	1.4	- 3.5	3.2
Chuck roast	1.3	- 1.6	1.8
Rib roast	1.2	- 2.2	4.8
Soda crackers	1.2	- 1.3	.6

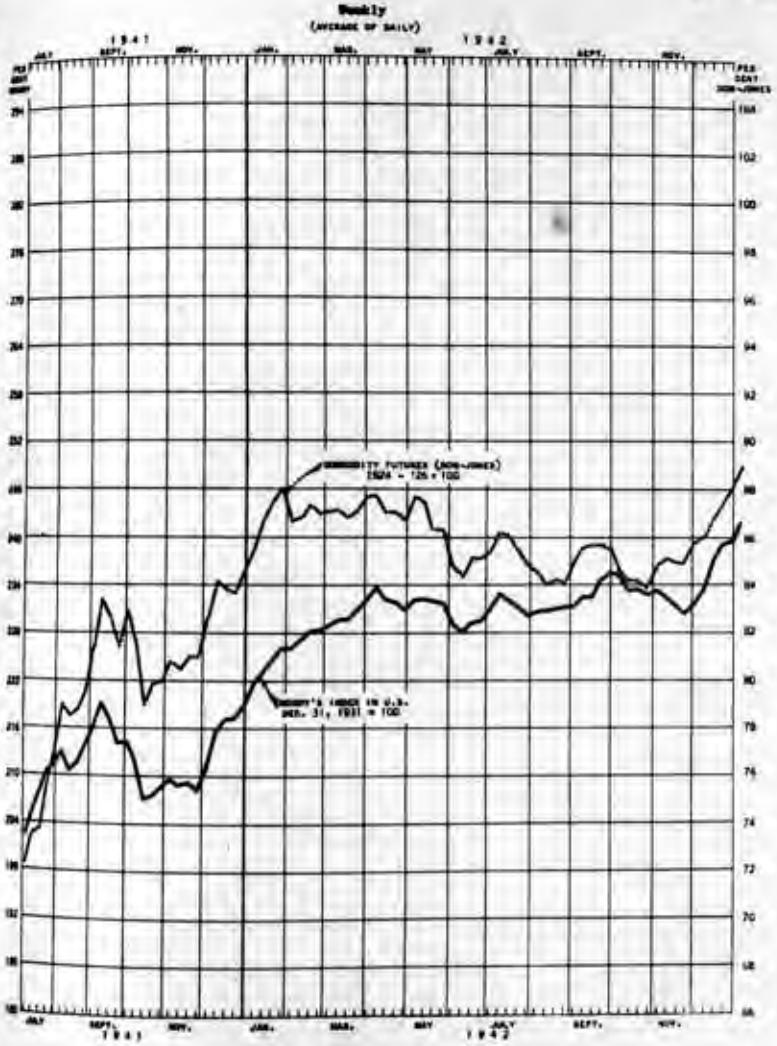
Price changes for individual food products
in BLS retail food price index
(continued)

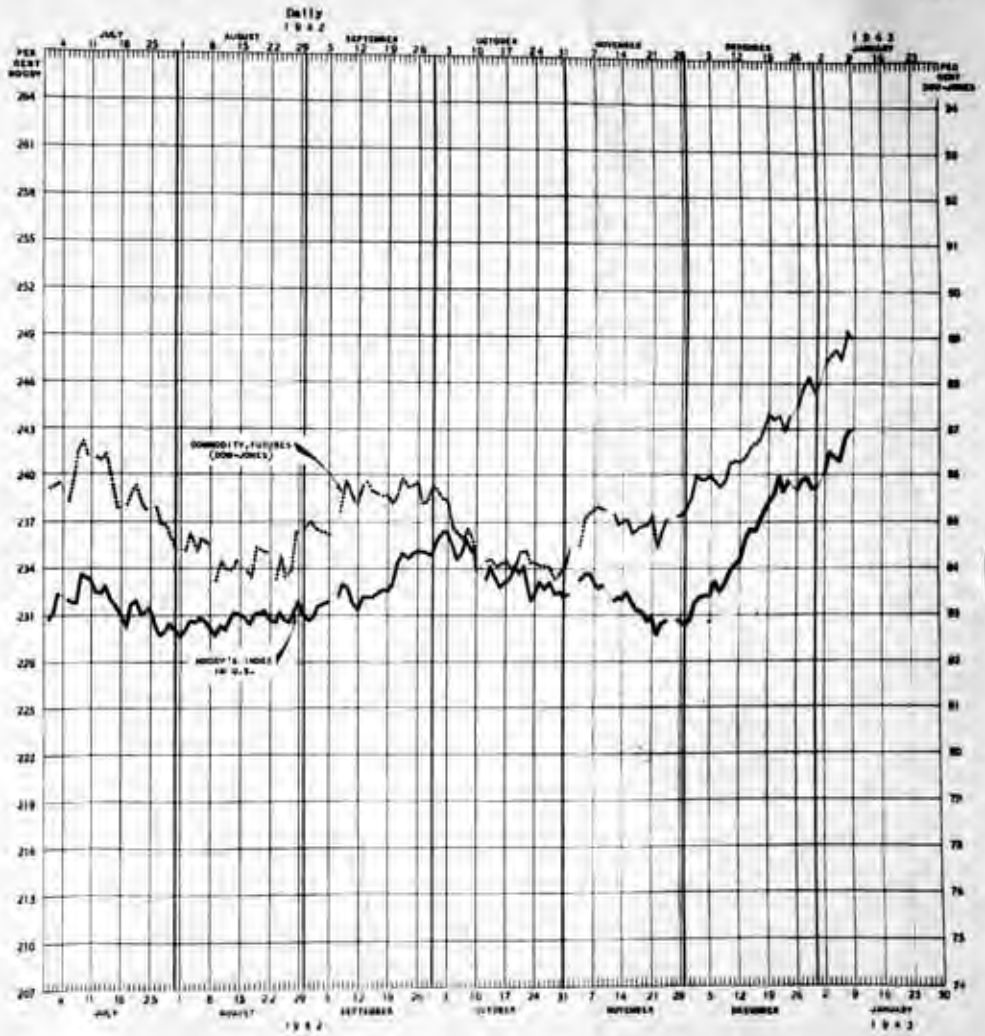
Commodity	Percent change December 1942 over September 1942	Percent change December 1940 over September 1940	Weight in food index 1/
Beans, navy	1.1	- 1.5	.4
Bread, whole wheat	1.1	- 2.2	.8
Cutlets	0.7	- 4.2	2.0
Macaroni	0.7	0.0	.9
Milk, fresh, delivered	0.7	2.4	11.5
Peas, canned	0.7	- 0.7	.8
Ham, whole	0.5	- 1.6	2.2
Shortening, other than lard	0.5	- 2.1	.7
Oleomargarine	0.4	- 1.9	.3
Rib chops	0.2	-11.4	1.5
Round steak	0.2	- 6.5	4.1
Bread, rye	0.0	- 3.2	1.1
Bread, white	0.0	- 3.7	6.5
Corn flakes	0.0	1.4	1.3
Pork chops	0.0	-19.1	3.7
Sugar	0.0	- 0.2	4.1
Salad dressing	- 0.8	- 2.4	.9
Coffee	- 0.3	- 1.4	2.5
Salt pork	- 1.3	9.3	.3
Cookies, vanilla	- 3.0	0.4	1.8
Tea	- 3.6	0.6	.8
Sweet potatoes	- 9.4	7.0	.3

1/ Weights change somewhat from month to month.

Source: Bureau of Labor Statistics.

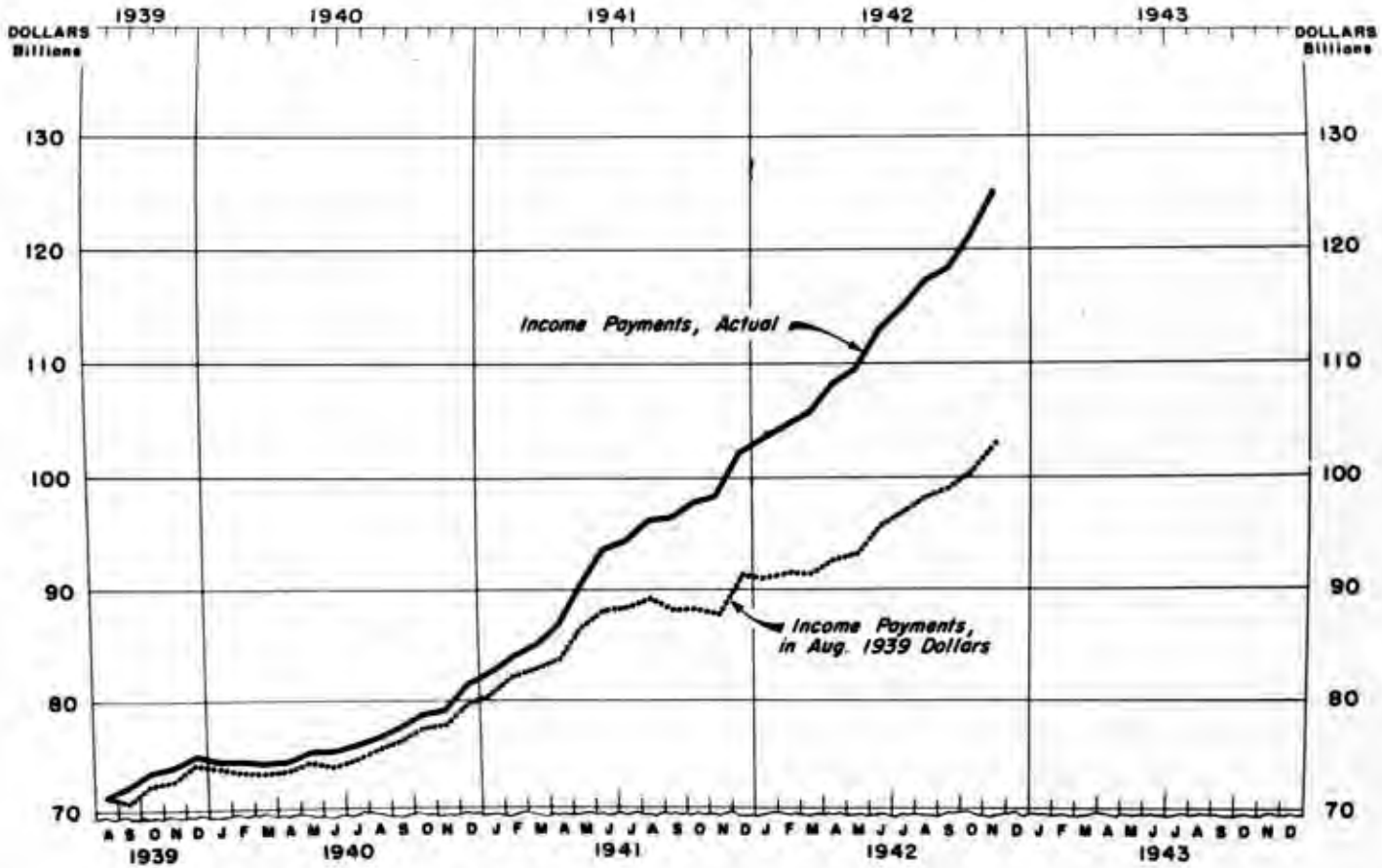
COMMODITY PRICE INDEXES IN U.S.





NATIONAL INCOME PAYMENTS

Annual Rate, by months



Office of the Secretary of the Treasury
Division of Research and Statistics

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Chart 3

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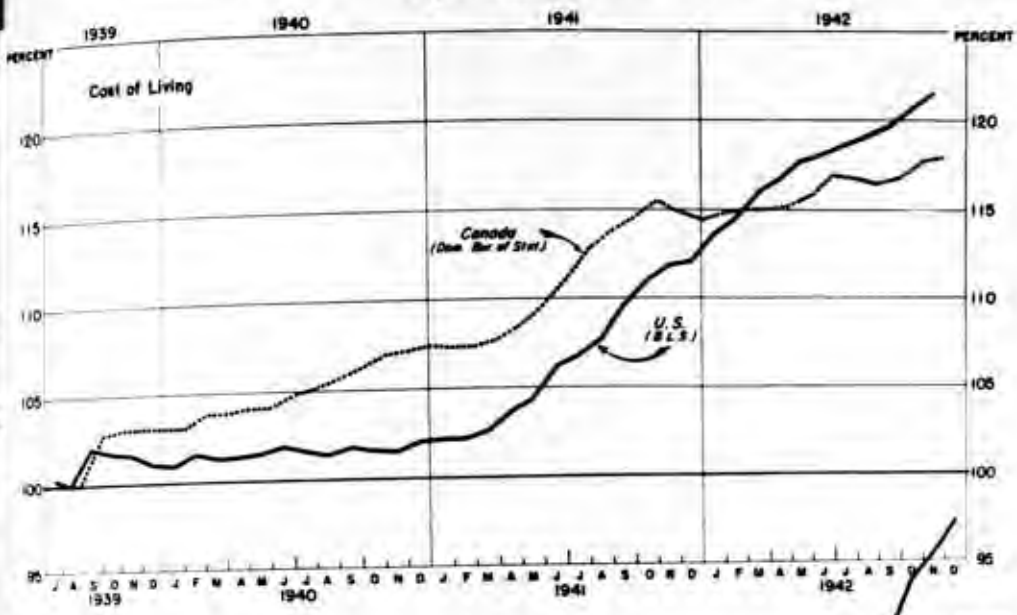
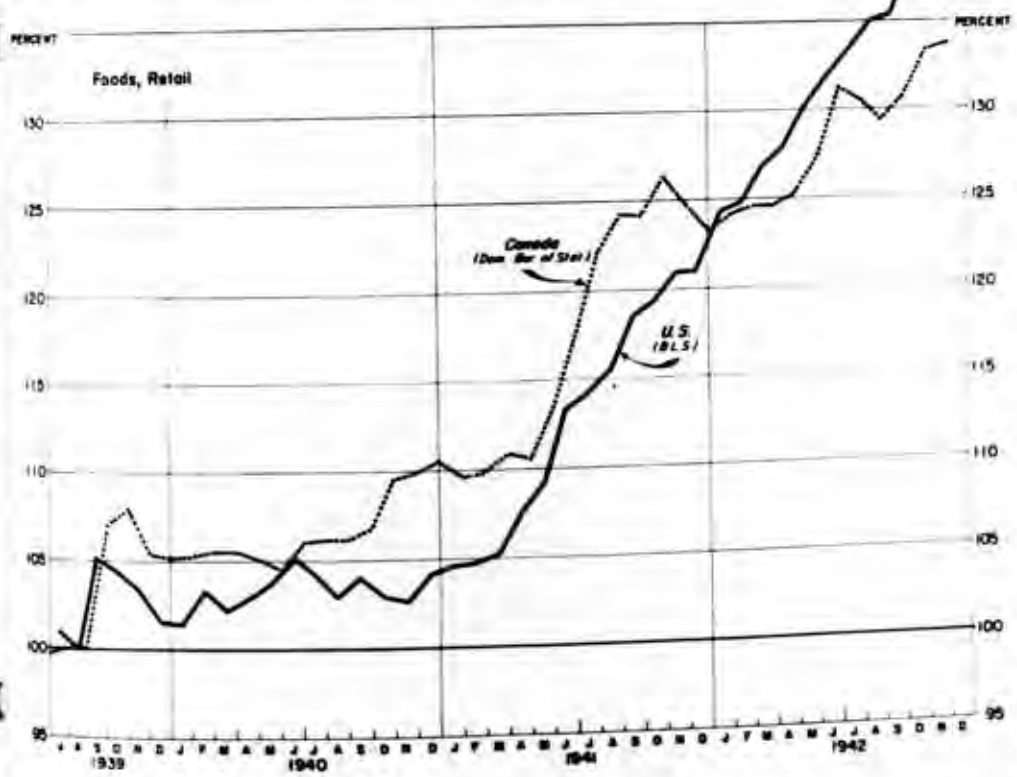
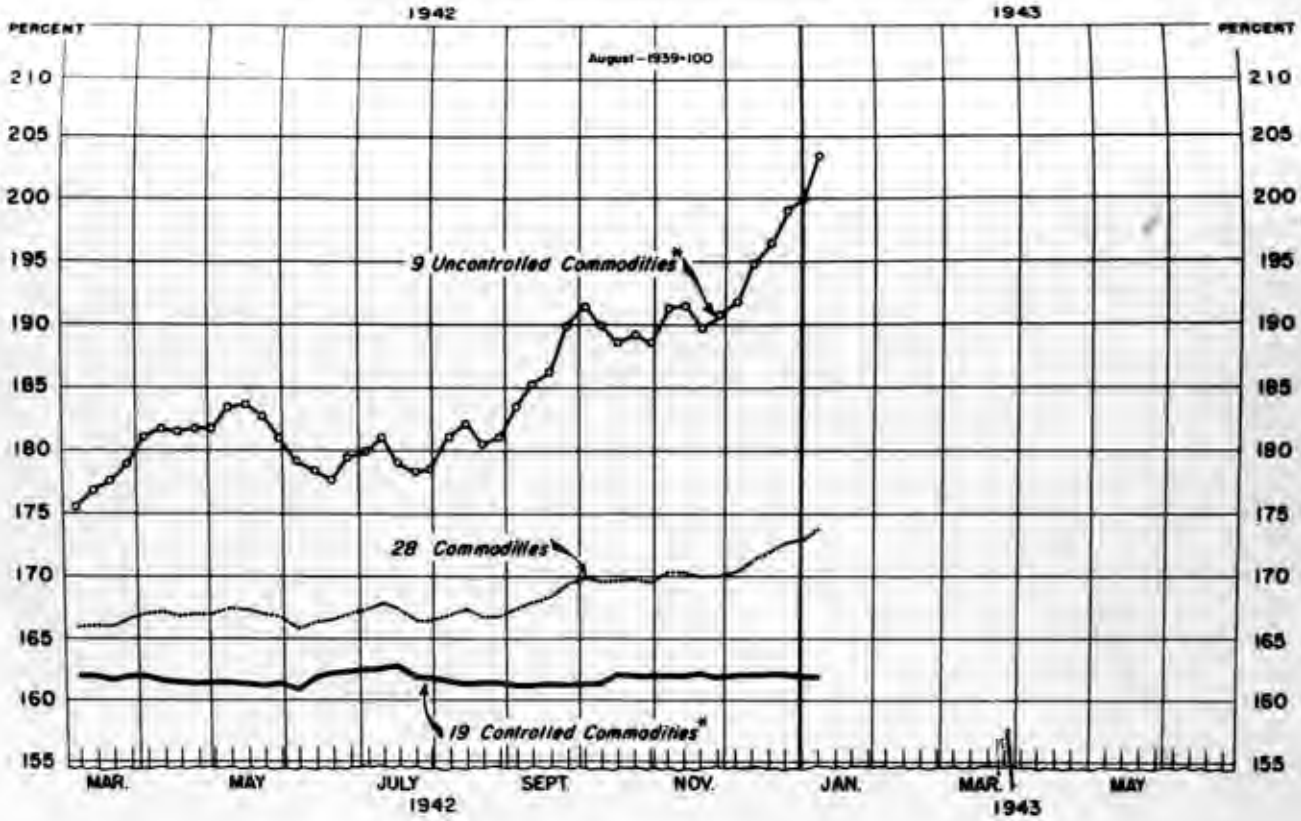
COST OF LIVING, U.S. AND CANADA

August 1939 = 100

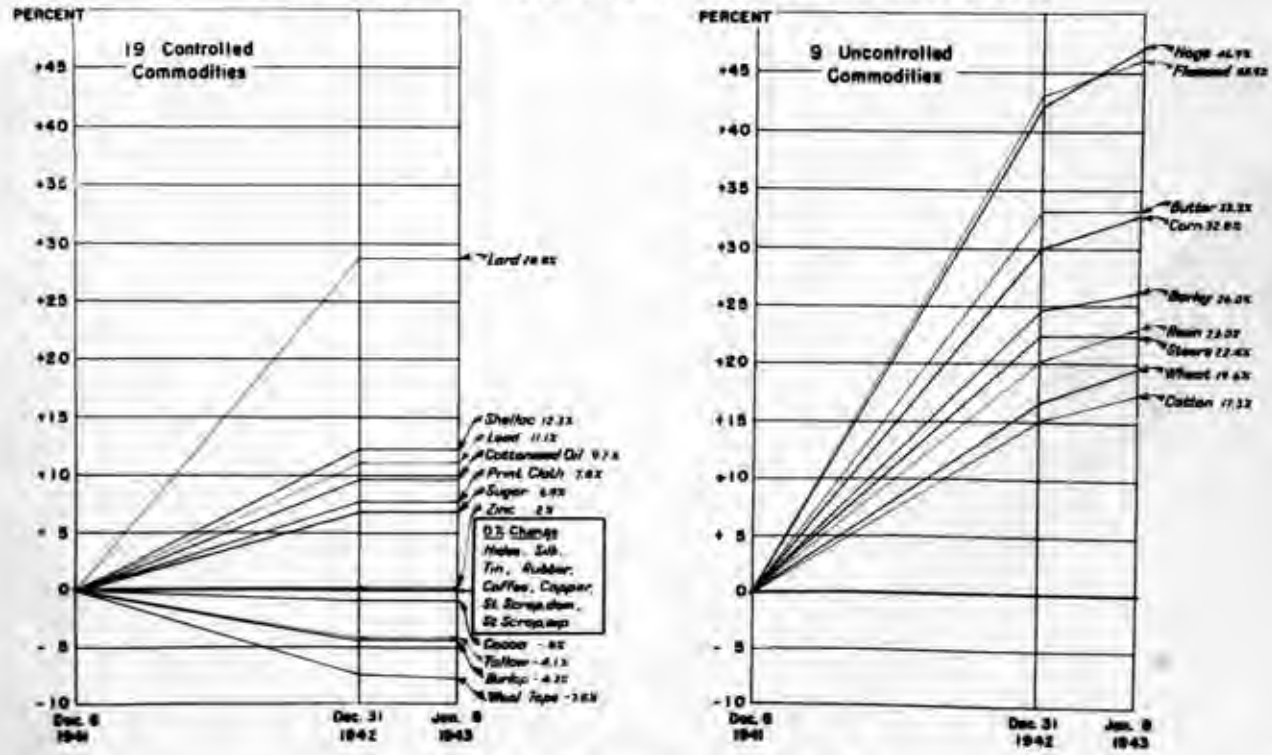




MOVEMENT OF BASIC COMMODITY PRICES



PERCENTAGE CHANGE DEC. 6, 1941 TO DEC. 31 AND JAN. 8, 1943

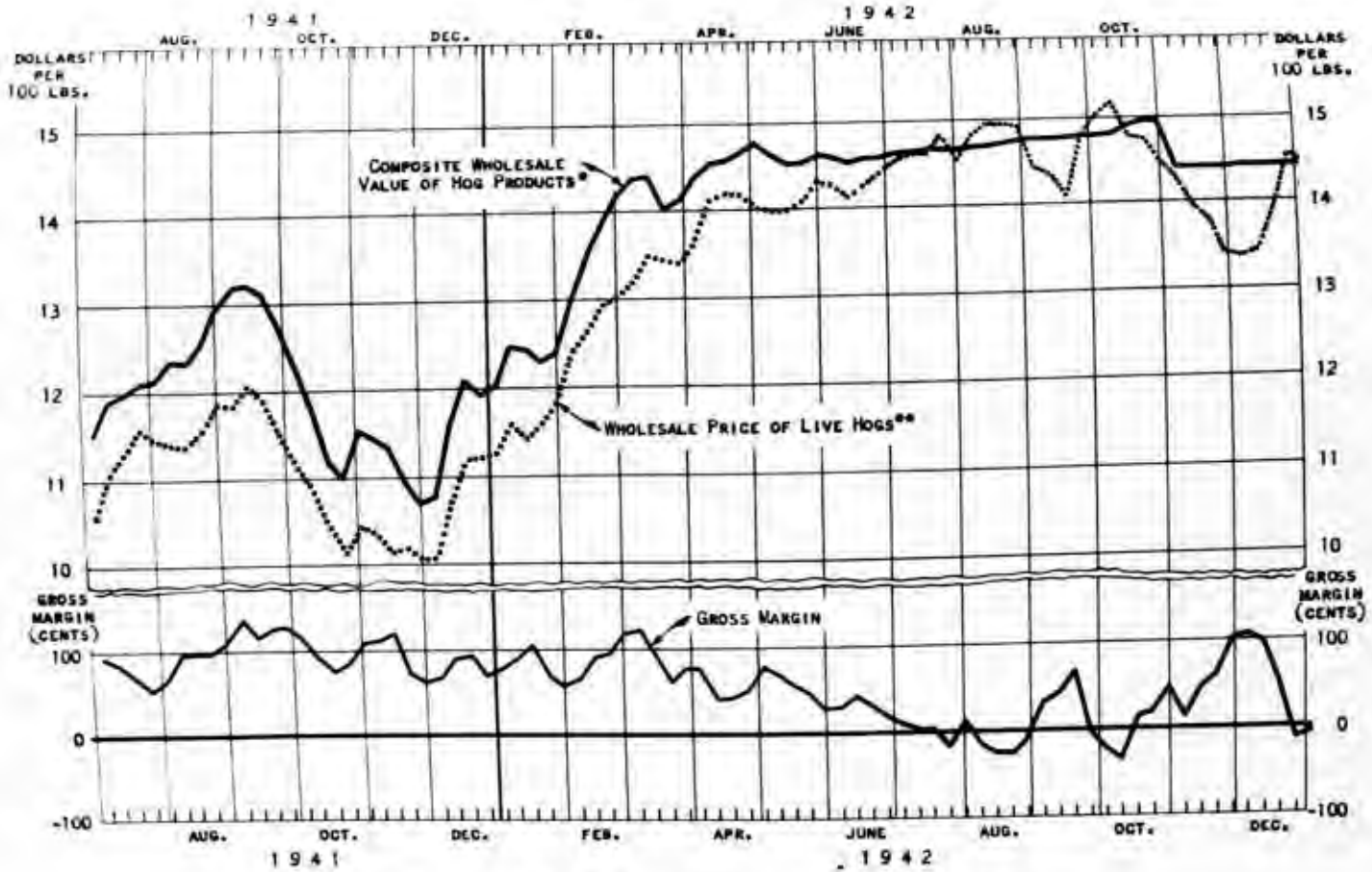


*20 Controlled and 8 Uncontrolled previous to June 26

Office of the Secretary of the Treasury
Division of Research and Statistics

HOG PRICES, VALUE OF PORK PRODUCTS, AND GROSS MARGINS

Weekly, July 1941 to date



* WHOLESALE VALUE OF ALL EDIBLE PRODUCTS IN 100 LB. OF LIVE HOGS.
** GOOD CHOICE, 180-200 LBS.

SOURCE: U.S.D.A.

Office of the Secretary [redacted]asury
Division of Research [redacted]

Chart 5

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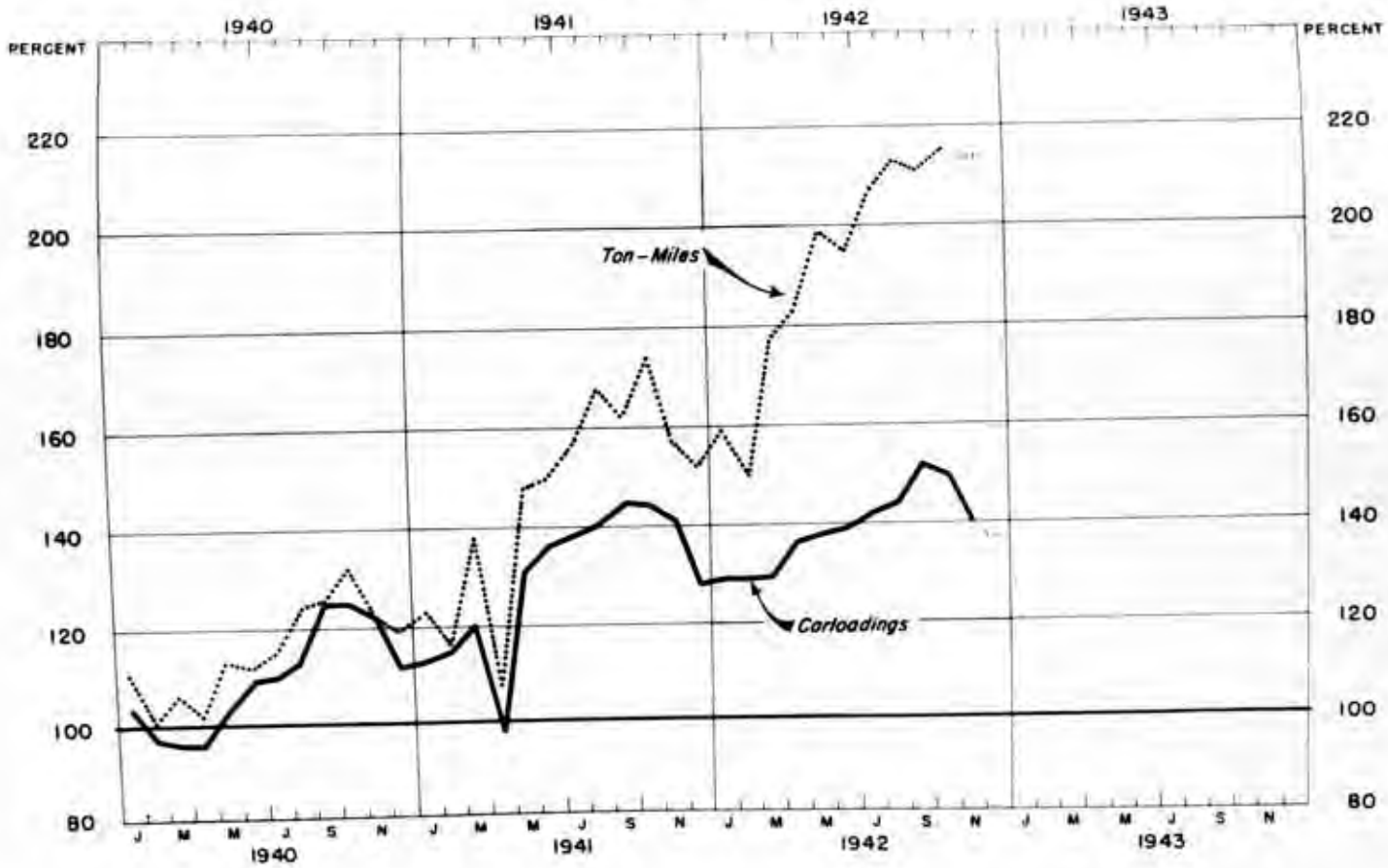
RAILROAD FREIGHT TRAFFIC
1935-'39 = 100



Office of the Secretary of the Treasury
Division of Research and Statistics

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Board of Economic Warfare
Executive Director's Office

MEMORANDUM

January 11, 1943

The Honorable
The Secretary of the Treasury
Washington, D.C.

Dear Mr. Secretary:

The Vice President asked us to notify you that the President had approved the recommendations respecting the dollar position. A photostatic copy of this memorandum is enclosed for your files.

Sincerely yours,

Milo Perkins
Executive Director

Attachment

OFFICE OF THE VICE PRESIDENT
WASHINGTON

Report to the President on Policy Decisions
Relating to Dollar Position of
Lend-Lease Countries

A committee consisting of representatives of the Departments of State, Treasury and War, the Office of Lend-Lease Administration and the Board of Economic Warfare, undertook to consider the following four problems:

1. The appropriate level of the gold and dollar balances of the United Kingdom. Should these balances be allowed to increase further or should an effort be made to hold them at approximately the present level or should they be reduced?

2. The desirability of continuing lend-lease exports to South Africa in view of the present size and rate of increase of the gold holdings of that country.

3. The extent to which in the formulation of lend-lease policy for sterling area countries the gold and dollar position of each of these countries should be considered as separate from that of the United Kingdom.

4. In granting lend-lease assistance to countries outside the British Empire, should their holdings of gold and dollar balances be taken into consideration?

Recommendations made in this report are based on the recognition that the purpose of the Lend-Lease Act is to provide our Allies with the goods and services that they need for the most vigorous prosecution of the war. They are based on the assumption that our arrangements with lend-lease countries should be so conducted as to maintain their gold and dollar balances at a level consistent with the above objective.

1. The United Kingdom:

The United Kingdom held, as of November 30, 1942, an aggregate of $928 million of gold and dollar balances as follows:

	(In millions)
Gold.....	$702
Dollar balances.....	226
Total	$928

This total of $928 million represents an increase of $770 million from the low point of May 1941 and an increase of $430 million since January 1942. Whether or not these holdings will increase in the near future depends on a number of factors within the control of the United States Government such as the volume of lend-lease aid, the volume of United States purchases and the dollar expenditures of and for our troops. It also depends on certain factors largely beyond our control, of which an example is the proposed substantial payment by the United Kingdom to Canada.

Judging the total British position at this time, we conclude that the balances now held by United Kingdom are adequate. In this connection, it will be recalled that in the Spring of 1941 the British suggested that they should have a "minimum working balance of $600 million required to meet contingencies everywhere".

Recommendation

It is recommended, in the light of present circumstances, that the United Kingdom's gold and dollar balances should not be permitted to be less than about $600 million nor above about $1 billion.

2. The Union of South Africa

Gold holdings of South Africa have risen from approximately $220 million in September 1939 to more than $600 million in November 1942. In addition, South Africa has repurchased about $160 million of government securities formerly held in the United Kingdom, as well as substantial amounts of gold mining securities.

South Africa's gold production is not expected to diminish greatly below the present all time high of $500 million per year. Even if gold production were to be drastically curtailed, South Africa would scarcely be hindered in her prosecution of the war because of any shortage of foreign exchange.

Lend-Lease exports to South Africa were unimportant until May 1942. Since then they have increased steadily. In October, 76 percent of United States exports to South Africa were on lend-lease account and 43 percent of the non-military items exported under lend-lease. These goods are lend-leased to Great Britain for the Union of South Africa, but they are shipped directly to the latter country. In the case of non-military goods, a large part is distributed by South African Government through normal commercial channels.

In view of the large gold balances of South Africa, lend-lease aid to that country, considered by itself, cannot be justified on foreign exchange grounds. It has been urged that political considerations make it important that lend-lease aid should be extended. There is, however, evidence to indicate that the Union Government is willing and eager to finance the purchase of war materials with its own resources.

Recommendations

a. It is recommended, as long as South African balances remain at or near their present high levels, lend-lease non-military exports to South Africa on a credit basis, either directly or indirectly through the British, be discontinued and that negotiations to this end be started at once.

b. It is further recommended that a Lend-Lease Agreement with South Africa be negotiated providing for lend-lease military aid to that country and reciprocal aid to the United States in the form of strategic materials.

3. The British Empire and its Parts

The present financial arrangements with the British appear to be rather inconsistent. When the British request that additional lend-lease aid be granted and that they be relieved of the necessity of making various dollar payments, they count only the United Kingdom's gold and dollar balances and most of the dollar receipts of the sterling area as being available.

They exclude the gold and dollar holdings of South Africa, Australia, New Zealand and India which together are at least as large as those of the United Kingdom. When, however, they compute the dollar expenditures which must be made, the British count not only the payments which the United Kingdom must make, but also the payments which their Dominions and Possessions, including South Africa must make.

It would seem that the correct procedure is to make lend-lease arrangements either with any part, or with the whole of the sterling area, and to vary the arrangements so as to fit the ability of the part, or the whole, to pay for goods and services. If Great Britain is to act for the whole Empire, the assets of all the members of the Empire should, it seems, be considered as well as their aggregate net need for foreign exchange. The same would hold for any part of the Empire for which Britain makes lend-lease arrangements.

Recommendation

It is recommended that the United States Treasury initiate and continue discussions with the Financial representatives of South Africa, Australia and New Zealand concerning their respective gold and dollar positions. Whether or not similar procedure should be adopted with British India rests upon the decision of the State Department concerning the expediency of such procedure with India at this time.

4. Non-British Countries Receiving Lend-Lease Aid

Thirty-six non-British Empire countries received $1.5 - $2 billion of lend-lease assistance through November 1942. Among them are countries with substantial gold and dollar holdings.

Recommendation

It is recommended that consideration in the determination of lend-lease policy should be given to the gold and dollar position as well as to all of the relevant factors.

5. Continuing Review

In order to implement the policy decided upon concerning the appropriate amount of gold and dollar balances to be held by various countries receiving lend-lease aid, it is necessary to have a closer degree of coordinated effort by the various departments making decisions affecting the dollar position of these countries and to give consideration to the ways in which that policy shall be implemented. It is also necessary to be informed concerning the countries to which lend-lease aid is being granted, either directly or indirectly.

If the balance rises above the upper limit decided upon by the policy committee, the most feasible method of reducing the contribution of the United States seems to be the following:

(a) Reduction in lend-lease exports of non-military goods.

(b) Procurement of strategic materials and other non-military supplies as reciprocal aid.

(c) Receipt as reciprocal aid of sterling to finance expenditures of American Armed Forces abroad.

Recommendation

It is therefore recommended that the Cabinet group appoint a permanent subcommittee under the chairmanship of the Treasury charged with the responsibility of making recommendations to this Cabinet group with respect to the implementation of policies relating to the above problems, and that the Secretary of the Treasury take the necessary steps to obtain from each of the United Nations the information on their foreign exchange resources needed for the work of the subcommittee.

H A Wallace
Vice President

Cordell Hull
Secretary of State

D W Bell
Acting Secretary of Treasury

Henry L Stimson
Secretary of War

E R Stettinius Jr
Lend-Lease Administrator

If you approve of these recommendations we shall be glad if you will so indicate below.

The White House

Approved: Franklin D Roosevelt

January 1, 1943

JAN 11 1943

My dear Mr. President:

There is attached a report of Lend Lease purchases made by the Treasury Procurement Division for the Soviet Government indicating the availability of cargo for January.

Tonnage at the end of January will be 611,635, an increase of 98,549 tons over December. Apparently this increase is again attributable to the lack of ships as this is the fourth consecutive month showing increased accumulations of materials in this country.

Yours sincerely,

(Signed) H. Morgenthau, Jr

The President

The White House

Del. by SSAgent 5:00 1/11/43

Copies in Diary

TREASURY DEPARTMENT - U. S. S. R.

MATERIALS AVAILABLE FROM STORAGE AND PRODUCTION DURING JANUARY 1945

COMMODITY	PRIORITY CARGOES SPECIFIED FOR JAN. 1945	AVAILABLE: STORAGE	AVAILABLE: IN TRANSIT TO STORAGE	AVAILABLE: PRODUCTION	BALANCE
STEEL BARS, SHEETS, STRIP, PLATES, SHAPES, ETC.	NONE	132,846	23,000	34,261	190,706
TOOL AND DIE STEEL	"	502	305	2,049	2,796
RAILROAD RAILS, WHEEL SETS AND ACCESSORIES	"	78,600	6,784	2,251	86,635
CABLE (OTHER THAN COPPER)	"	-	-	1,706	1,706
WIRE PRODUCTS	"	47,359	12,320	21,526	81,124
PIPE AND TUBING	"	107,168	8,029	23,481	138,678
TIN PLATE	"	17,280	2,180	472	20,932
COPPER AND COPPER PRODUCTS	"	20,804	17,297	8,970	46,771
ZINC	"	-	-	2,820	2,820
ALUMINUM AND ITS PRODUCTS	"	100	25	38	163
NICKEL AND ITS PRODUCTS	"	21	1	380	402
FERRO ALLOYS	"	1,040	800	405	2,245
MOLYBDENUM	"	-	-	320	320
CHEMICALS	"	1,328	325	306	1,959
MERCURY	"	-	120	-	120
INDUSTRIAL AND CONSTRUCTION MACHINERY, MATERIAL, ACCESSORIES AND PARTS	"	10,109	7,325	7,204	24,638
AUTOMOTIVE EQUIPMENT AND PARTS	"	41	20	320	401
TIRES AND TUBES	"	405	25	240	677
FIRE FIGHTING EQUIPMENT	"	70	-	-	70
GRAPHITE - METAL ELECTRODES	"	2,100	650	520	3,270
CLOTHING AND TEXTILES	"	140	105	-	245
RUBBER PRODUCTS	"	45	270	289	604
HAND AND MACHINE TOOLS	"	172	219	956	1,347
BALL AND ROLLER BEARINGS	"	44	27	582	653
PAPER AND PAPER PRODUCTS	"	1,170	112	452	1,734
MEDICAL SUPPLIES AND EQUIPMENT	"	1	18	-	19
HARDWARE	"	320	73	-	393
MISCELLANEOUS SUPPLIES AND EQUIPMENT	"	448	666	2	1,111
		24,247	79,464	108,324	212,035

OFFICE OF THE DIRECTOR

TREASURY DEPARTMENT

PROCUREMENT DIVISION

WASHINGTON

January 11, 1943

MEMORANDUM TO THE SECRETARY:

Supplementing my report to you of January 4, 1943, the purchases against the Rehabilitation Program from January 4, 1943 to January 10, 1943, totaled $929,215.05, or a total of purchases for the program thus far of $8,314,356.72.

Since submitting previous reports we have been able to segregate tonnage provided by Agriculture and Army, both as to amount exported and at port, which included 3948.75 tons exported and 6797 tons on hand at port. These have been deducted and will not appear in future reports.

The committee, headed by Governor Lehman, is working very closely with the Lend-Lease Administration and all efforts are being coordinated through the War Production Board and Smaller War Plants Corporation for utilizing all available facilities and for the elimination of strategic materials.

Clifton E. Mack
Director of Procurement

SHIPPING REPORT AS OF JANUARY 9, 1943

Commodity	Shipped To Date From U. S. A.	Under Load At Port	On Hand At NYC Waiting Vessels	En Route To Port
New & used clothing	123.5 tons	375 tons	247 tons	93 tons
Cotton piece goods	203 "	1710 "	1500 "	4129 "
Shoes	-	-	220 "	-
Refined Sugar	301.5 "	2733 "	602 "	-
Raw sugar	1377 "	245 "	-	-
Powdered milk	113.5 "	6 "	-	-
Tea	171.5 "	-	-	-
Matches	127.5 "	143 "	96 "	-
Nails	4.3 "	-	-	-
Drugs	6.067 "	-	-	-
Copper sulphate	1925 "	675 "	1500 "	-
Books & booklets	2 "	-	-	-
Lamp chimneys	-	-	17 "	-
Phonograph records	-	-	-	1000 each
Newsprint	-	39 "	-	300 tons
Printers ink	-	.089 "	-	-
Mach. finished book paper	-	2 "	-	-
Cordage & twine	-	230 "	70 "	-
Thread	-	31 "	81 "	-
Lactose	-	2 "	-	-
Cotton hose	-	-	25 "	-
Totals	4054.867	6691.089	4418	4522

THE BRITISH SUPPLY COUNCIL IN NORTH AMERICA

TELEPHONE REPUBLIC 7880

BOX 680
BENJAMIN FRANKLIN STATION
WASHINGTON, D. C.

January 11,1943

SECRET

Dear Dr. White,

The gold and dollar figures for December, 1942, are as follows:

	Dec. 4	Dec. 11	Dec. 18	Dec. 23	Dec. 31
Total Gold (incl. Belgian)	797	797	802	810	793
Official dollar Balance	228	229	235	235	243
Total Gold and Dollars	1025	1026	1037	1095	1036
Less: Belgian Gold	105	105	105	105	105
Scattered Gold	234	234	183	184	72
Gold Reserve against immediate liabilities	10	10	10	10	10
AVAILABLE GOLD AND DOLLARS	676	677	739	746	849

I apologise for the delay in sending them over.

Yours sincerely,

E.W. Playfair

Dr. H.D. White
Director of Monetary Research
United States Treasury
Washington, D.C.

BRITISH AIR COMMISSION
1785 MASSACHUSETTS AVENUE
WASHINGTON, D. C.

TELEPHONE HOBART 9000

PLEASE QUOTE
REFERENCE NO.....

With the compliments of British Air Commission

who enclose Statement No. 67 - Aircraft Despatched

- for week ended January 5, 1943.

The Honourable Henry Morgenthau, Jr.
Secretary of the Treasury
WASHINGTON, D. C.

January 11, 1943.

MOST SECRET

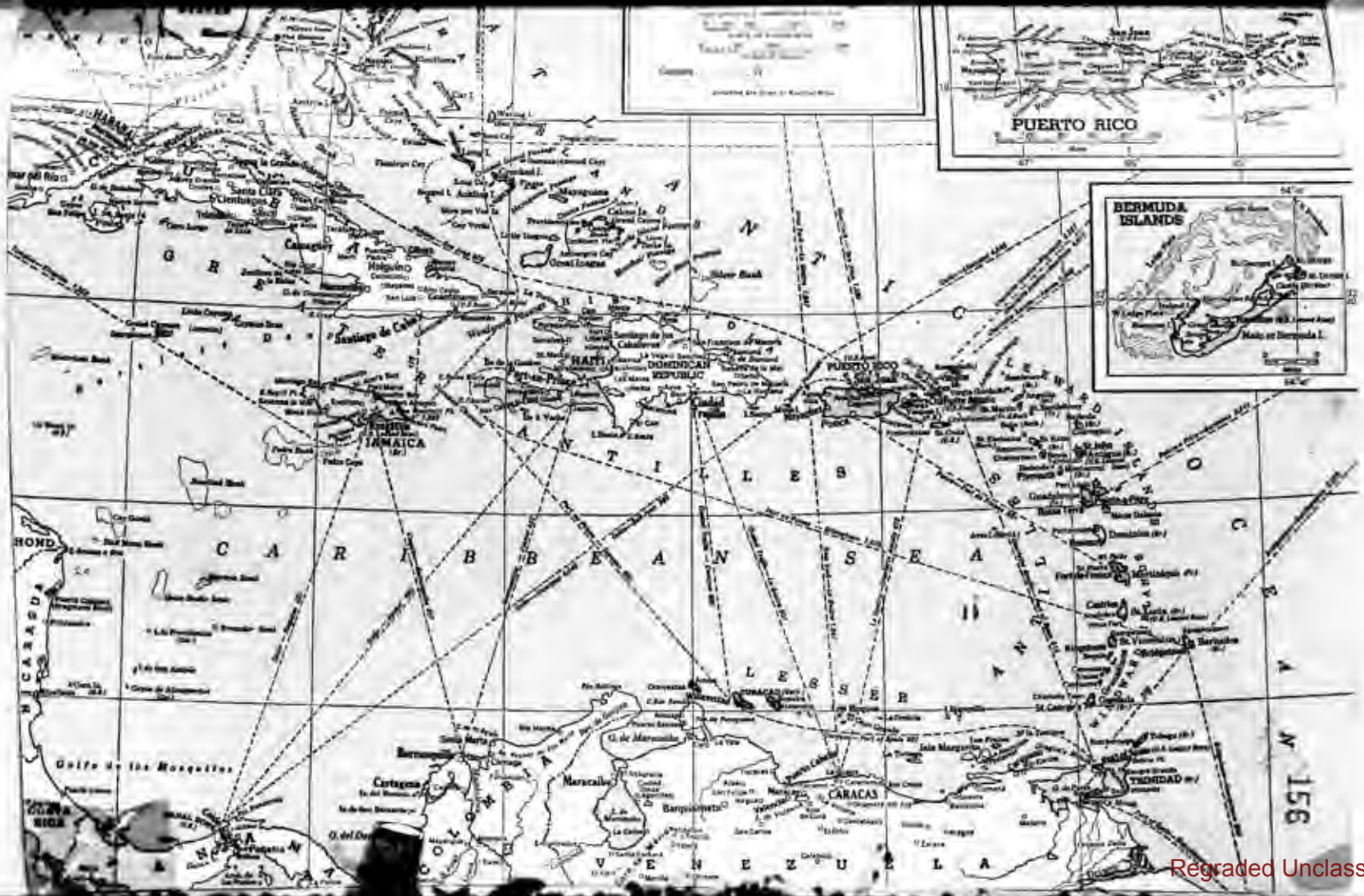
STATEMENT NO.67

Aircraft Despatched from the United States

Week Ended January 5th, 1943

Type	Destination	Assembly Point	By Sea	By Air	Flight Delivered for use in Canada
CONSOLIDATED					
Catalina 1B	U.K.	Bermuda enroute		8	
Liberator GR V	U.K.	Canada enroute		1	
DOUGLAS					
Boston III A	U.K.	U.K.		9	
CURTISS					
Kittyhawk	Middle East	Port Sudan	2		
BREWSTER					
Bermuda	U.K.	U.K.	10		
FAIRCHILD					
Cornell PT26	Canada	Canada			8
GLENN MARTIN					
Baltimore III A	Middle East	Middle East		10	
LOCKHEED					
Hudson VI	West Africa	Freetown		5	
Ventura	S' Africa	S' Africa		3	
NORTH AMERICA					
Mitchell II	Bahamas	Nassau		2	
Harvard	India	Bombay	14		
VULTEE					
Vengeance	India	Bombay	30		
WACO					
Waco Gliders	U.K.	U.K.	1		
		Total	57	38	8

Movements Division,
British Air Commission.
9/1/43



CUBA

Treasury Department
Division of Monetary Research

January 1943

(This report prepared by John S. deBeers and L. Larry Leonard.)

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CUBA

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Part III. (cont'd) Page

PART I

CUBA

I. United States Aid and Cooperation

1. Sugar Purchases -- U.S. Defense Supplies Corporation.

Negotiations for purchase of the 1943 Cuban sugar crop began in Washington last November and at the latest report were still continuing. On January 13, after a five-hour meeting in the Presidential Palace in Habana, attended by President Batista, leading Cabinet members, and members of the Cuban Economic Mission which had been negotiating with the United States, it was announced that the sugar grinding season would be postponed to February 15. This was interpreted as indicating a crisis in the negotiations. Ordinarily the official opening of the grinding season is in the middle of January; the February 15 date will be the latest for beginning the grinding season in the history of the crop.

It is reported that the United States Government offered to purchase 2.6 or 2.8 million tons (long tons?) at a price of 2.65 cents per pound, f.o.b. Cuba, with producers covering storage costs. The Cuban producers have been disappointed, however, and after a six-hour meeting on January 15 decided to continue negotiations, with the hopes of obtaining a better price which will include freight and storage costs. Because the shipping shortage and submarine danger have made impossible the export of all Cuba's 1942 crop, the various U.S. Government

agencies concerned agreed that considerably less sugar should be bought in 1943, and apparently our negotiators have insisted upon this reduction.

During the past year the failure of the U.S. to commit itself on 1943 sugar purchases caused concern to the Cubans. Leaders in the Cuban sugar industry urged President Batista last May to place a ban on further planting of cane until the U.S. requirements were definitely known and in June the Cuban Government apparently acceded to this request.

The Defense Supplies Corporation, acting as purchaser not only for this country but indirectly for both Great Britain and Russia, purchased Cuba's entire 1942 sugar crop (estimated at 4.5 million short tons), except for small amounts needed locally and to cover previous contracts. A substantial part of the 1942 harvest is still in Cuban warehouses awaiting shipment. The basic minimum price under the 1942 contract was 2.65 cents per pound f.o.b. Cuban port, which was almost a cent above the average 1941 prices, but less than one-fourth of the 1920 price. The contract included the sugar content of both blackstrap and high-test molasses at 2.50 cents per pound. In July 1942, the Defense Supplies Corporation entered into an additional purchase agreement with the Cuban Sugar Institute for 34 million gallons of high-test molasses to be used in alcohol production.

During early 1942 the United States and Cuba discussed the possibility of buying Cuban industrial alcohol. Cuba's capacity for distilling alcohol is about 20 million gallons a year. Because of the shipping shortage, some agencies of the United States Government were anxious to concentrate shipping on the movement of alcohol rather than molasses. Apparently this contract was not completed, although Cuba was anxious to go through with it. The Board of Economic Warfare regarded the price the Cuban monopoly was demanding as "blackmail and unreasonable".

2. Gold Agreement of July 6, 1942

Under this agreement, the United States Treasury undertakes to sell gold to Cuba to be held on earmark in New York. Payment for such gold is to be made in dollars at the Federal Reserve Bank of New York within 120 days after date of sale. The amount of gold for which payment is still to be made shall not exceed $5 million at any one time. The obligation of the United States Treasury to sell gold under these terms expires June 30, 1943, subject to earlier termination at any time.

The purpose of this agreement is to permit the Cuban Government to acquire gold as a reserve for silver certificates (a reserve of 98 percent in gold or dollars is required against such notes). In practice, the Cuban Government acquires U.S. currency for pesos in Havana and then holds such currency as a reserve against peso silver certificates, or uses such

currency to purchase gold for earmark in New York. At the request of the Cuban Minister of Finance, the U.S. Treasury sold $20 million in gold for earmark in New York against immediate payment in dollar currency at Havana branches of United States banks. The advantage of such an arrangement to Cuba is that it avoids the cost to the Cuban Government of shipping such currency to New York. The advantage to the Treasury is that we receive immediate payment for gold sold, and we can use the dollar currency in Havana for payments by the Government or for sale to United States banks.

The Cuban Government has issued 20.4 million pesos of silver certificates backed by the $20 million of gold sold by the U.S. Treasury. An additional 5.1 million of peso certificates has been issued backed by $5 million in dollar currency. We have been requested by the Cuban Minister of Finance to sell $10 million additional in gold for immediate payment in dollar currency at a Havana branch of the United States bank. This gold will be sold in lots of $5 million when the Cuban Government is prepared to make payment in United States currency in Havana.

3. Printing of Cuban Peso Notes by the United States Treasury.

Following the suggestion of the American Technical Mission, the Cuban Government requested the United States Treasury to utilize the facilities of our Bureau of Engraving and

printing to provide peso silver certificates to a total of 106 million pesos. On March 25, 1942, the Treasury agreed to execute the order on a cost basis. The first part of this order for a total of 48 million pesos has been completed and delivered to the Cuban Government in Havana. The second part of the order for 58 million pesos is to be executed when the request is received from the Cuban Government. This will depend upon the progress made in re placing United States dollar currency with Cuban currency, and on the setting up of the Central Bank recommended by the American Technical Mission. The peso is now approximately at par. If Cuban currency remains at par or at a premium no technical difficulties should be experienced in further substituting Cuban currency for dollar currency.

4. American Technical Mission to Cuba.

At the request of the Cuban Government, the American Technical Mission was organized in 1941 to study and make recommendations on Cuba's banking and monetary system with special reference to the creation of a Central Bank. The Mission was composed of H. D. White, Chief of Mission, and G. A. Eddy, F. A. Southard, Jr., and H. R. Speigel (of the Treasury Department), W. R. Gardner and G. B. Vest (of the Board of Governors of the Federal Reserve System) and A. T. Essate (of the Farm Credit Administration). After spending several weeks in Cuba, the Mission completed its

first report on November 26. This report dealt only with certain immediate problems, recommending that Cuba build up an official dollar or gold reserve and acquire dollars for this purpose by the issuance of peso currency. The currency would be backed to almost its entire face amount by the reserves of dollars or gold thus acquired. The Mission's Second Report, dated April 22, 1942, contained its principal recommendations regarding a Central Bank for Cuba. A copy of this report is appended hereto, along with two subsequent reports commenting on proposed monetary and banking legislation which had been drafted in Cuba.

The only major report not yet transmitted is that on the Agricultural Bank, and a draft of that has been evolved which is satisfactory to all members of the Mission. Nevertheless, the Mission feels that presentation of the report at this time might lead to creation of a bank which might be used in risky-war-time emergency financing, thereby endangering the long-run success of the institution. Senores Lopez Castro and Garcia Montes, when they were in Washington last month, discussed the matter with us but as yet no agreement has been reached whether it would be desirable to postpone submission of the report. We are waiting to hear from the Cubans.

Bills on the Central Bank and banking and monetary legislation were presented to the Cuban Congress last June by President Batista, and hearings were held in Habana, beginning

November 5 and continuing through the first part of December. Although progress on the Central Bank enterprise has seemed extremely slow, both Lopez Castro and Garcia Montes stated that in their opinion the legislation will be passed in the near future. The Cuban Congress adjourned on December 11 without having taken definitive action on the subject, but it has been reported that an extraordinary session will soon be held with the Central Bank legislation one of its topics for consideration.

During the course of preparation of this report, the Mission discussed its proposals with bankers both in Cuba and in the United States and weighed very carefully the suggestions of the banking groups. Nevertheless, the bankers have expresed considerable opposition to the report and have influenced Ambassador Braden to the adoption of their views. Their chief objection is that the Cuban Government is unreliable and untrustworthy and that the creation of a Central Bank which would place monetary control in the hands of the Government is not to be recommended. The Mission, on the other hand, although recognizing these dangers, advised the creation of a bank which will place control over the monetary system of Cuba in the hands of a Government bank. In connection with the opposition to the project expressed by Ambassador Braden, Mr. Frank A. Southard went to Habana on behalf of the Treasury

Department to make a further investigation into his objections and it has been the conclusion of the Mission, after re-examination of the objections that its recommendation should be maintained.

An exchange of letters between some New York bank officials and the Mission discuss the chief points at issue.

5. Military Cooperation and Lend-Lease Aid.

Cuba declared war on the Axis immediately after the United States declaration, and the island has been selected as the United States base of supply for the whole Caribbean area. The United States has enlarged its naval bases at Guantanamo and Bahia Honda as well as on the Isle of Pines, and a modern airfield has been built at Camaguey. On September 7, 1942, a military and naval agreement was signed with Cuba which further coordinated the forces of the two countries.

A Lend-Lease Agreement was signed with Cuba on November 7, 1941, with a total commitment of $7.2 million. Cuba has asked for an additional commitment but this has not been granted yet since total shipments to date amount to less than $800,000 -- $2,000 during the first half of 1942, $328,000 in the third quarter, $399,000 in October and $44,000 in November. The terms of the agreement call for a maximum total repayment by Cuba of $4.2 million (58-1/3 percent) and this is to be spread over six years, with the required annual installment limited to $700,000. The distribution of Lend-Lease shipments to

Cuba through November 1942 was as follows:

(Highly Confidential)

Ordnance and ordnance stores	$ 14,895
Aircraft and aeronautical materials	738,519
Tanks and other vehicles	9,434
Industrial and other commodities	10,530
Total	$773,378

6. Export-Import Bank.

There are at present two Export-Import loan authorizations outstanding to Cuba. A $25 million commitment to the Republic of Cuba, authorized on May 1, 1941, is to be used for a wide variety of public works and measures directed toward expanding industry and agriculture in Cuba. This loan is scheduled to expire on June 30, 1946. Another commitment of $15 million to the City of Habana was authorized in April 1942 for purposes of installing and improving the city's waterworks system. So far there have been no disbursements under either of these commitments, largely because of the inability to obtain needed materials from the United States.

In the past few years, the Export-Import Bank has, however, actually disbursed and been repaid some $38.5 million in connection with Cuban loans. $27.2 million of these arose out of agreements in the middle 1930's under which the Bank bought silver bullion, had it minted in Philadelphia, and was then paid in dollars on delivery of the pesos to the Cuban Government.

In 1941 the Bank also disbursed $11.3 million for purposes of helping Cuba store and grind part of her sugar crop. This permitted Cuba to hold her crop and get substantially higher prices than would otherwise have been possible. In August of 1942, the Sugar Stabilization Institute turned over to the Cuban National Treasury $2.4 million, representing about one-fourth of the profits from this sugar transaction, to be used as a retirement and social assistance fund for sugar employees.

7. Metals Reserve Corporation.

The U. S. Metals Reserve Corporation has signed a series of contracts with individual producers in Cuba for the purchase of manganese ore, chromium and copper. Some of these contracts are with local producers but the majority are with foreign-owned companies. Statistics on shipments to date are not available but it is reported that substantial amounts have been reaching the United States. However, shipping difficulties are presenting serious problems. The Metals Reserve Corporation hopes to get manganese ore shipments up to 400,000 tons per year and chromium deliveries up to some 300,000 tons per year in the near future.

8. Reciprocal Trade Agreements.

The trade agreement signed with Cuba in August 1934 was the first concluded under the Hull Trade Agreement Program. This agreement has been modified and supplemented by two other

agreements signed in 1939 and 1941. The Cuban agreements differ from other reciprocal trade agreements of the United States in specifically providing for preferential tariff rates, and in fact by increasing the preferences enjoyed by the United States and Cuba in each other's markets.

The major economic significance of the Cuban trade agreements has been a reduction in the duty on sugar imports into the United States from 1.50 cents per pound to 0.75 cents per pound, the last rate being finally reached in the 1941 supplementary agreement. The reduction in sugar duty was, however, coupled with quantitative restrictions on the importation of sugar into the United States under various sugar control acts, so that Cuba has benefitted not so much from increased quantities shipped to the United States as from a more remunerative price obtained from the shipments to this market. In addition to the sugar concession, the United States made important reductions in duties on tobacco, fresh fruits, and winter vegetables, while Cuba has improved the tariff position of numerous United States products, including lard, petroleum, and automobile products.

9. Cuban Laborers for Work in United States.

Negotiations between the United States and Cuba for the employment of Cuban workers in United States war industries are reported to be progressing satisfactorily. The Cuban Government has insisted that the labor contract include a

guarantee that wages will not be inferior to those earned in Cuba and for the return of workers to Cuba if they are not satisfied. Approximately 10,000 skilled Cuban workers are said to be available for work in the United States.

10. Agricultural Assistance and Advice.

To offset Cuban disappointment at prospects for an unfavorable 1943 sugar contract, the State Department is seeking to negotiate purchase contracts for critical agricultural commodities which Cuba can produce. The Defense Supplies Corporation is expected to conclude these purchase agreements, covering such articles as castor beans, peanuts, and jute substitutes. The contracts are expected to extend into two or three post-war years and to involve total sums as high as several million dollars a year. Development of these fields of production will be aided by technical experts loaned by this Government.

In February-March 1941, a five-man commission from the United States Department of Agricluture went to Cuba to study the country's agricultural potentialities, and in April 1941 it presented a lengthy report. Much of the subsequent agricultural cooperation has been based on this report. Partly as an outgrowth of this technical study, the two Governments signed an agreement in April 1942 regarding use of the $25 million Export-Import Bank loan as it affects agricultural developmental programs.

The studies and recommendations of the Agricultural Technical Commission covered crop diversification, rural rehabilitation, irrigation, rice production, refrigeration and storage facilities, reforestation, agricultural research, tick eradication, and other matters. The principal recommendations were:

(a) Diversification of agricultural production. With good land abundant in Cuba, both foodstuffs and additional export crops can be grown there readily. The Commission commented favorably upon the possibilities of developing the following crops: rice, bananas, peanuts, African oil palm, onions, cacao and kudzu, and advocated further experimentation with numerous other commodities.

(b) Rural rehabilitation. This is urgently needed as a result of years of relatively low sugar production and the consequent extension of the dead season to eight months or more in some years. Government land and lands to be acquired by purchase should be distributed among low-income farm families under a program somewhat similar to the Farm Security Administration.

(c) Irrigation. Five irrigation projects were inspected and approved by the Commission. Eight other

irrigation projects which had been drawn up should be studied further and beginnings made in this field immediately.

(d) Increased rice production. Rice is one of the mainstays of the Cuban diet, with a per capita consumption of over 100 pounds per year. Cuban needs, however, have in the past been met by imports even though there is sufficient land to grow about one-half of her requirements. This recommendation is related to the irrigation projects mentioned above.

(e) Refrigeration and storage facilities. These would enable Cuba to become much more self-sufficient with respect to beans and corn, both of which are produced abundantly in Cuba but deteriorate rapidly under present conditions of poor storage protection.

PART II

II. Current Economic Situation

1. Supplies and Prices

As a result of shipping and priority difficulties Cuba is facing an economic slump. There are not enough ships to move the sugar crop, and the warehouses probably cannot hold a large accumulating surplus. Imported foodstuffs are limited and priorities restrict the importation of materials necessary for domestic production of foods. The lack of iron and oil imports is seriously curtailing the construction industry with a resultant increase in unemployment. The cessation of tourist trade is a serious blow to Habana.

The cost of living in Cuba has increased about 21 percent in the past year and nearly 50 percent since 1939. The food price index, however, has increased by some 38 percent in the past 12 months. The rising prices are due both to increased incomes resulting from a large sugar crop sold at high prices and severely restricted imports of many consumers' goods.

Index of Retail Food Prices

(July-Dec.1937 = 100)

1939	Av.	93.7	1942	Jan.	112.4
1940	Av.	92.0		March	123.0
1941	March	94.4		May	132.8
	June	98.9		July	135.9
	Sept.	101.6		Sept.	139.6
	Dec.	108.3			

In May the Cuban Government set up an Office of Price Regulation and Supply with broad powers to fix prices and prevent speculation. This agency has decreed general whole-

sale and retail price ceilings for nearly all industrial and agricultural products of both domestic and foreign origin. The ceilings are based on prices prevailing in March 1942, but prices have continued to rise despite these regulations. Some rationing controls have been instituted for gasoline and tires. It is planned in the future to ration also many of the necessary foodstuffs.

2. Foreign Exchange Situation.

Exchange Rates. During 1936-1941 the peso was below par, with average discounts of around 10-12 percent during the first war year, 1939-1940. After August 1940 there was rapid strengthening of the rate. Recent yearly average quotations are as follows:

1937	99.1 cents per peso
1938	98.1 " " "
1939	92.8 " " "
1940	90.1 " " "
1941	97.3 " " "
1942	100.2 " " "

Since September 1941 the peso has been at par or at a premium with respect to the dollar. Small premia during most of 1942 facilitated the issuance of $20 million additional peso currency and the acquisition of dollar and gold reserves to the same amount. (An additional $5 million was issued in January 1943). Recently, however, the premia have disappeared and an exact parity is being maintained.

Monetary Reserves. The monetary reserves of Cuba total $53 million at market values, and represent an average of 52 percent reserve against the outstanding paper currency. These

reserves are made up of silver pesos held against the original issues of silver certificates, and gold or dollars held against the "silver certificates" which were issued under the law of May 2, 1942, requiring a backing of 98 percent. The change in composition of these reserves following the law of last May and recommendations of the American Technical Mission are shown in the following table:

Table 1.--Monetary Reserves of Cuba

(In millions of dollars)

	Dec. 31,1941	Oct.31,1942	Jan.15,1943 1/
Gold bars in New York	-	15.0	20.0
Gold coin in Habana	1.2	1.2	1.2
United States dollars	-	5.0	5.0
Silver pesos 2/	21.4	27.4	27.4
Total reserves	22.6	48.6	53.6
Cuban paper currency outstanding	78.2	97.0	102.0
Ratio of reserves to paper currency	29.0 percent	50.1 percent	52.5 percent

1/ Estimated on the basis of earlier figures and the recent gold purchase.

2/ Valued at 35 cents an ounce on December 31, 1941 and 45 cents an ounce on October 31, 1942; monetary values were 78.9 and 78.7 million pesos, respectively.

3. Cuban Government Finance.

Although the regular budgetary accounts of the Cuban Government show a sizeable deficit, which is expected to grow to about $10 million by the end of 1942, extra-budgetary

accounts have produced a substantial surplus which roughly offsets the deficit in the regular budget.

The 1943 budget, concerning which very little information has been received in Washington, was said to provide $22 million for the Armed Forces according to a newspaper report in early November. According to this information, the National Defense expenditures were to be the largest single item out of the $90 million total budget.

Comparison of Cuban public finance figures over a period of years is almost impossible because of varying utilization of extra-budgetary accounts. In 1942, for example, many accounts which formerly had been outside were brought into the regular budget. However, there are special new 1942 accounts outside the budget which draw upon earmarked sources of revenue for specific expenditure purposes. The following table presents a general picture of Cuban public finance during the last two years, insofar as data are available in Washington.

Table 2.--Cuban Public Finance, 1941-1942

(1,000 pesos)

	1941		1942	
Receipts				
Regular	75,779		95,724	
Special	2,000	1/	10,473	2/
	77,779		106,197	
Expenditures	77,549		104,810	

Table 2--Cuban Public Finance, 1941-1942 (cont'd.)

(1,000 pesos)

		1941		1942
Budgetary Balance	Surplus	230	Surplus	1,387 3/
Extra-Budgetary Items				
Receipts 4/	-			9,300
Expenditures 4/	-			7,146
			Surplus	2,154
Apparent Balance on All Items			Surplus	3,541

1/ Revenues collected during 1941 for repayment of the Standard Oil advances to the Government made in December 1940.

2/ Funds transferred to the regular budget from proceeds of the special tax surcharges.

3/ Despatch No. 384 of January 7, 1943, from Habana, gives the figures stated above and reports a surplus of 1,186,000 pesos; the discrepancy of about 200,000 pesos is not accounted for.

4/ Comprises (a) tax surcharges created September 8, 1941 (minus portion allocated to regular budget), (b) taxes for defense and other emergency purposes created December 31, 1941 and February 16, 1942, and (c) taxes for Export-Import loan service, established November 22, 1941. Expenditures under these categories do not include sums used to retire short-term Government debt.

Even though the extra-budgetary surpluses are available for meeting regular budget expenses, they have in practice been accumulated separately, and only to a relatively small extent have they been allocated to the regular budget. The Government has even resorted to borrowing with short-term Treasury notes to finance its budgetary deficit while there were extra-budgetary surpluses. However, these short-term

borrowings have been retired out of the proceeds of extra-budgetary receipts, thus in effect tapping those receipts for the regular budget via a devious route, while other Government cash assets were immobilized voluntarily in the extra-budgetary accounts.

The principal sources of governmental revenue are import duties and sales taxes. Unfortunately, the current reports of revenues do not clearly indicate the nature of all sources of funds. During the last year, customs revenues have declined slightly, because of the decrease in quantity of imports. Internal taxes (chiefly sales excises) have on the other hand become more important.

4. Foreign Trade.

Despite shipping difficulties and priority regulations, the value of Cuban imports, under the influence of higher prices, was 26 percent higher during January-July 1942 than during the corresponding period of 1941. Cuban exports, on the other hand, increased only 1.9 percent over the first seven months of 1941. As a result, Cuba's favorable balance on commodity trade fell from $46.5 million in the first seven months of 1941 to $29.8 million in the same period of this year. The export surplus during 1941, however, was the largest in recent years.

Table 5.--Cuban Foreign Trade, 1937-1942

(in millions of dollars)

	Imports	Exports	Balance
1937	129.6	186.1	+ 56.5
1938	106.0	142.7	+ 36.7
1939	98.5	137.4	+ 38.9
1940	93.5	114.6	+ 21.1
1941	130.6	206.2	+ 75.6
1941 - Jan.-July	73.1	119.6	+ 46.5
1942 - Jan.-July	92.1	121.9	+ 29.8

Though no 1942 data are available as to the commodity composition of Cuba's foreign trade her seven major exports are sugar and its by-products (70-80 percent); tobacco (7-10 percent), fruits, vegetables, and other foodstuffs (4-7 percent), minerals (3-5 percent), meat (2 percent). Her major import commodities in past years have been foodstuffs (25-30 percent), textiles (18-20 percent), machinery (12-15 percent), and chemicals (10-12 percent).

The United States supplied 84 percent of the Cuban imports during the first seven months of this year, as compared with 87 percent of the total in the same period last year and 78 percent in 1940. The value of imports from the United States was, however, 21.2 percent greater than in 1941. Receipts from the other Americas were 127 percent greater in the 1942 period than in 1941. This was primarily the result of increased imports of rice from Mexico, Ecuador, and the Dominican Republic; fuel oil, chick peas and cotton textiles from Mexico; crude rubber from Ecuador, and tallow, cork products, quebracho, and linseed oil from Argentina. Imports from Spain, Switzerland, Australia

and Brazil were off sharply. The details are shown below:

Table 4--Cuban Imports During First Seven Months
(in millions of dollars)

	1941	1942
United States	63.6	77.1
Mexico	.8	3.7
Other Americas	3.6	6.3
United Kingdom	1.7	1.8
Other Europe	1.5	.5
Asia	1.8	2.7
Other	.1	-
Total	73.1	92.1

Notwithstanding the increased value of importations, Cuba is suffering severely from lack of certain imports. The shortage of petroleum derivatives is very acute. The lack of steel and iron imports is threatening to paralyze completely the construction industry with a consequent increase in unemployment. The stocks of many basic food items are also nearly depleted and contribute to the rapidly rising cost of living.

Cuban exports to the United States constituted almost 93 percent of the total during the first seven months of 1942 as against 90 percent in the comparable 1941 period and 82 percent in 1940. The United Kingdom and Russia accounted for the bulk of Cuban exports to Europe this year. Cuban exports to the other Americas declined from $4.4 million during the first seven months of 1941 to $3.3 million in the same period of 1942. This decrease was primarily due to the

fact that sales of refined sugar to Mexico have been practically nil this year.

Table 5.--Cuban Exports during the First Seven Months
(in millions of dollars)

	1941	1942
United States	108.0	113.3
Mexico	1.2	-
Other Americas	3.2	3.3
Russia	-	1.4
United Kingdom	4.7	3.2
Other Europe	1.7	.3
Asia	.5	-
Other	.3	.4
Total	119.6	121.9

Exports of fruits and vegetables have been cut very drastically due to transportation difficulties and the exportation of beef has been prohibited by the Government on the ground that all available cattle were needed for domestic consumption. The low prices paid in Cuba, however, have made the cattle growers reluctant to sell on the domestic market.

5. Cuba's Public Debt

Cuba's external and internal funded debt totaled $121 million as of June 30, 1942, and all is being serviced. This total does not include (a) Cuba's floating debt, recent estimates of which are not available, but which was estimated at $45 million as of June 30, 1941, or (b) two recent issues of

short-term Government notes, totaling $2.2 million, which were floated to cover current expenditures. An earlier 60-day note issue of $1.4 million was retired out of available extra-budgetary funds, and it appears that the two subsequent issues can similarly be retired.

Amortization of Cuba's funded debt was $5 million during a recent twelve-month period. The composition of the debt is shown below:

Table 6.--Cuban Government Debt, 1941 - 1942

(in millions of dollars)

	June 30, 1941	June 30 1942	Decrease
External			
$35 million 5s of 1904	4.0	3.0	1.0
$16.5 million 4½s of 1909	6.5	5.8	.7
$10 million 5s of 1914	2.7	2.3	.4
$50 million 5½s of 1923	16.2	14.7	1.5
$85 million 4½s of 1937	80.5	79.2	1.3
$8.7 million 4½s of 1941	8.7	8.6	.1
	118.6	113.6	5.0
Internal			
$11.2 million 5s of 1905	7.4	7.4	1/
Total bonded indebtedness	126.0	121.0	5.0
Floating debt	45.0 2/	n.a.	n.a.

1/ Only $50,000 reduction.

2/ Estimated.

Most of the funds derived from these various bond issues were used to fund floating debts and for public works.

The Speyer loans of 1904 and 1909 were used to pay obligations arising from the war of independence and for public works in Havana and Cienfuegos.

The Morgan loan of 1914 was used for retiring the floating debt and the completion of sewers and paving in Havana.

The Morgan loan of 1923 was used principally for clearing up floating indebtedness and a small part went for public works.

The Morgan loan of 1927, which was practically an extension of the 1923 loan, was used to liquidate the floating debt which had not been taken care of by the 1923 financing.

The Sugar Stabilization loan was used to finance Cuban participation in the Chadbourne Plan of sugar control.

Interest on Cuba's funded debt is being paid regularly. Sinking fund payments have been in arrears in several instances, but maturities have been met none the less.

The Internal Funded Debt consists of one issue of 5 percent bonds floated in 1905 to pay obligations arising from the war of independence. Bonds having a value of $11,174,000 were originally issued, of which $7,467,000 was outstanding as of January 31, 1940. Interest has been regularly paid. There are no stipulated sinking fund requirements and no maturity date is specified but the Cuban Congress has from time to time appropriated funds for redemption of the bonds.

The Floating Debt consists largely of unpaid judgments and claims against the Cuban government.

Its gross amount is estimated at between $45 million and $55 million. No interest is being paid on this indebtedness, and its exact amount is not capable of determination, owing in considerable part to the fact that some of the claims, in the opinion of governmental officials, can and should be settled for considerably less than the amount asserted. On the other hand, some of the claims are based upon judgments of courts of record and represent overpayments of taxes; some represent unpaid salaries and pensions; these claims should be paid in full. Governmental officials have expressed a desire to adjust these claims, to convert them into a part of the funded debt, and to provide for a sinking fund for the gradual retirement of the obligations.

The Public Works Debt was contracted by the Machado government.

Although he was elected on a pledge not to increase the public debt, he entered into a huge public works program certain to involve expenditures in excess of normal Cuban revenues. The financing of the program was the most involved in the history of Cuba since the plan had to evade the doctrine of the Platt Amendment prohibiting the flotation of loans in excess of Cuba's capacity to pay -- this capacity to be decided and permission obtained from the United States government. The plan adopted was successful and the Machado administration contracted a public works debt totaling $100 million.

The Chase National Bank advanced $60 million by 1930

The financial plan adopted worked as follows: The Cuban government issued "deferred payment work certificates" to the contractors executing the public works plan (of which the principal firm was Warren Bros. Co. of Massachusetts, who had charge of construction of the Central Highway). The Chase National Bank then purchased these certificates at par and was to receive 6 percent on the amount advanced.

The first agreement signed by the Chase National Bank and the Cuban government (February 1927) provided for a credit of $10 million to be extended in this fashion and to mature between September 1930 and June 1, 1931. It soon became evident that this credit was insufficient so in June 1928 a new agreement was drawn up increasing the total credit which the Chase National Bank was to place at the disposal of the Cuban government to $60 million. This credit was to be repaid within five years, hence requiring annual payments as high as $12 million. The entire credit of $60 million was used up by March 1930. Of these amounts, $20 million in serial certificates had been sold to the public and $40 million ($30 million in serial certificates and $10 million in deferred work certificates) were being held by the bank.

In 1930 part of this debt was funded and the Chase National Bank extended $20 million more.

By 1930 it became evident that the Cuban government would be unable to meet the large maturities so a new contract was

signed with the Chase National Bank on February 26, 1930, designed to place the financial arrangements on a more permanent basis. Under this agreement $40 million in serial and work certificates held by the bank were funded into 52 percent gold bonds maturing in 1945 and the bank extended an additional $20 million one-year credit (the term of which was continually extended until 1937) for the purchase of work certificates, thus raising the total advanced to $80 million. The agreement also provided for the issue of an additional $40 million in long-term bonds but they were never issued.

Cuba thereafter issued to the contractors $20 million more in Treasury obligations.

This represented additional funds over to the contractors for the completion of the work. Inasmuch as no further credits were granted by the Chase National Bank, the contractors (primarily Warren Brothers) were forced to hold these obligations themselves.

Since the first $20 million in serial certificates (which had been sold to the public) matured early in 1930 and were paid off, the total of this debt amounted to $80 million which was used in the following manner:

	(In millions of dollars)
Construction of central highway	$66.2
Construction of new capitol	10.0
Miscellaneous projects	3.8
Total	$80.0

The amounts outstanding after 1933 were held as follows:

(In millions of dollars)

$40.0	Public works gold bonds (1945) sold to public.
$20.0	Short-term credit of 1930; due to Chase National Bank.
$20.0	Treasury obligations held by contractors (Warren Brothers and a Cuban company)

The Mendieta government challenged the legality of the Chase loans.

In April 1934, it appointed a Commission to examine the Chase loans and to recommend action to be taken. In June 1934, the Commission reported that insofar as the Chase National Bank was concerned, the right of repudiation was indisputable; that as far as the bondholders are concerned, from a legal standpoint, the government has good reason also to decide for repudiation, but suggested that on ethical grounds the government should make some settlement with the public who held the bonds bought in good faith. The Commission's finding that the loans were illegal were based on the supposed illegality of acts of the dictatorial Machado government and the contention that the Chase Bank knew that the money was not being spent honestly.

In 1938 an $85 million loan was floated to readjust the Public Works Debt.

These bonds were issued in April 1938 in exchange for indebtedness as indicated below:

(Units of $1,000)

	Claimed	Settlement: New Bonds
Gold bonds 5-1/2% - 1945	$40,000	$40,000
Interest	8,800	4,000
Short-term credit held by Chase and associates	20,000	20,000
Interest	4,400	
Commissions	750	
Serial certificates - held by Chase	867	867
Interest	215	88
	$75,032	$64,955

In addition to the above public work obligations, bonds of this issue were assigned to settle long standing railroad obligations, none of which had ever been considered as part of the public works debt 10,163

Total new bonds issued $75,118

Held by approximately 17,000 bondholders in the United States and Cuba, mostly in the United States.

This leaves about $10 million in unissued bonds for the settlement of the remainder of the official public works debt. The pending claims, the most important of which are shown below, amount to $30.8 million.

Treasury obligations held by:

(Units of $1,000,000)

Warren Bros. (American) and the Cuban contractors (Cuban)	$20.0
Interest	6.7
Cuban Treasury promissory notes - held as above	1.6
Interest	.4
Obligations on account of construction of the national capitol held by Purdy and Henderson (American)	1.5
Interest	.5
Other items	.1
Total	$30.8

PART III

III. GENERAL AND POLITICAL HISTORY

1. Columbus discovered Cuba in 1492

On his first voyage, Columbus in October 1492 visited the island which was called Cuba by the Aborigines but which he named Juana or Jane. After exploring it for some distance on the north he concluded that it was part of the Asiatic Continent and was so certain that he was close to Cathay that he sent two agents to search for the court of the Great Khan to present him with compliments of Ferdinand and Isabella.

It was settled by Spaniards in 1515

Settlement of islands was far easier than settlement of the mainland since the number of natives which could resist was small and could be easily overpowered. In 1508 Sebastian de Ocamp sailed around Cuba for the first time establishing the fact that it was an island, and conquest and occupation began immediately. By 1515 there were seven settlements on the island, one of which was Havana.

Cuba was one of the last of the Spanish possessions to break away from Spain

Throughout the nineteenth century, however, Cuban history is characterized by conspiracies, insurrections, and wars on behalf of freedom from the mother country. Aside from maladministration, the primary reason for Cuba's desire for freedom was the fact that other nations were interested in Cuba because of its size and its strategic location. Most Cuban revolutionaries

desired annexation by either Columbia, Mexico, or the United States, with a slight preference for the United States. Although plotters against Spanish rule sent agents to the United States as early as 1822 to learn whether Cuba would be admitted to the Union if it freed itself without American help, the United States Government remained aloof and acted merely to prevent the acquisition of Cuba by any other nation.

In 1895 a revolution against Spain was headed by Jose' Marti, a poet, and Thomas Estrada Palma, who later became the first president of the republic. The United States Government protested to Spain against measures taken to quell the revolt and McKinley's annual message of 1896 hinted at intervention. This attitude on our part was resented by Spaniards in Cuba and led to anti-United States demonstration, and the American Consul-General in Cuba requested that a war vessel be sent for protection. When the vessel arrived (the Maine) it was blown up in the Havana Harbor and the Spanish War ensued. The American victory freed Cuba from Spanish rule.

2. <u>An American military governor was in charge of Cuba from August 1898 to May 1902</u>

During the two and one half years that General Leonard Wood was in charge of the Cuban Government, reconstruction work was being carried on. Order was restored, sanitation measures were embarked upon and malaria was brought under control. In 1901 a convention was held and a Cuban constitution was drawn up before turning over the government to the newly elected Cuban

officials, the United States required Cuba to insert the provisions of the Platt Amendment in this constitution. After some pressure was exerted upon the Cuban constitutional assembly, the Platt Amendment was accepted and the Cuban officials took over the government in May 1902.

The Platt Amendment was deeply resented in Cuba

Its important provisions were the following:

a. that the Cuban government was to make no treaties with foreign powers impairing its independence;

b. that it contract no debt which could not be met by the ordinary revenues of the country;

c. that it consent to the intervention of the United States for the presentation of independence and orderly government in Cuba;

d. that it lease or sell to the United States lands for coaling or naval stations.

It was felt that acceptance of these principals placed the Cuba government under the control of the United States, inasmuch as that government would decide when intervention was necessary. Despite the fact that it was a constant source of irritation to Cubans, the Platt Amendment was not repealed until May 1934.

The United States Government has actually intervened in the internal affairs of Cuba on numerous occasions

The more important instances of such intervention prior to 1932 are the following:

a. Following difficulties arising out of presidential elections in 1905, the United States landed military forces. An American governor administered the government from 1906 till 1909.

b. In 1912 troops were landed and stationed in Cuba to protect copper mines and sugar mills during the negro insurrection.

c. On several occasions during 1911 and 1912 the United States protested the granting of concessions by the Cuban Government to both American and European companies.

d. In 1916 the United States Government sent warships and landed troops in Cuba when a rebellion broke out against Menocal. The United States issued statements indicating its opposition to rebel forces.

e. In 1917 the United States again sent troops to prevent possible destruction of sugar by revolution against Menocal. The troops were not withdrawn until 1922.

f. In January 1921 President Wilson sent General Crowder to Cuba as his personal representative. Crowder, who in 1923 became Ambassador, remained in Cuba until 1927 and during this time actively participated in the government administration of Cuba. When an uprising occurred in 1924, the United States Government put an embargo on sales

of munitions to insurrectionists and sold war equipment to the Cuban Government.

3. Machado was elected President of Cuba by a large popular majority in 1924

He campaigned on a liberal platform and was unquestionably the popular choice. Although he had formerly been the manager of the Cuban branch of General Electric, he at first opposed foreign interests and worked to make Cuba economically independent of the United States. Though he ruled virtually as a dictator, controlling the press and ruthlessly putting down all opposition, corruption was less rampant than under Zayas, his predecessor, and more interest was shown in the general welfare. New emphasis was placed on sanitation and health and a central highway was constructed from one end of the island to the other. In order to complete the project he was forced to borrow $80 million from the Chase National Bank of New York.

Machado was ousted by force in 1933

The most general resentment aroused against Machado during his first administration was caused by his attempt to postpone elections until 1930. This move failed but an amendment extending the presidential term to six years was ratified and by the autumn of 1928 he had things sufficiently well in hand to secure unopposed reelection to this long term. Opposition to what seemed like an attempt at gaining "permanent" control was increased by the economic depression. Feeling against the government expressed itself in demonstrations by high-school and

university students and political factions. Plots and uprisings followed. Machado resorted to martial law and closed the schools. Both the government and the opposition resorted to terrorism and open fighting between opposing forces occurred for some months. In May 1933 Sumner Welles was sent to Havana as Ambassador to Cuba with instructions to try to end the political difficulties. Although fighting ceased for a time, a general anti-Machado strike occurred in August. On August 11 the military forces turned against him and on August 12 he left by plane for Nassau.

Impartial observers contend that Machado was able to remain in power as long as he did only because of support of American interests

The New York banks seem certainly to have contributed to his power by extending credits and floating bonds for the Cuban Government which was under his personal control. By extending up to $80 million to be used for public works, the Chase National Bank placed at Machado's disposal funds to be used to keep himself in power.

4. Cespedes was recognized by the United States Government but failed to obtain general support.

Before fleeing from Cuba, Machado accepted the resignation of all Cabinet members except his Secretary of War, Alberto Herrera, who took office as Provisional President. Herrera then appointed Carlos Manuel de Cespedes Secretary of State and resigned, thus making Cespedes the President in accordance with

the Cuban constitution. On the same day President Roosevelt announced that "the change of government now taking place in Cuba is in entire accord with the recognized constitution and laws of that country. . .", thus recognizing Cespedes as head of the Cuban government. However, since Cespedes was generally thought of as a supporter of Machado, he was widely opposed by powerful political elements in Cuba. On the night of September 4, 1933, Sergeant Fulgencio Batista lead a revolt of the army against its officers and assumed control of the armed forces. Batista was backed by the university students and others who had opposed the Machado administration, so Cespedes immediately resigned.

Grau San Martin was opposed by the United States

The overthrow of the Cespedes regime was followed by the establishment of a government headed by President Grau San Martin, professor of medicine at the university, who was supported by many of the elements which had opposed Machado and American intervention in Cuban affairs. The Grau administration immediately promulgated a "Statute for the Provisional Government" defining general principles which would guide it. The first was that the government would above all "maintain the absolute independence and national sovereignty" of Cuba while respecting existing treaties. The government promised to hold elections for a Constitutional Convention the following April and enacted a great number of decrees, among which were those establishing an 8-hour day, requiring employers to hire at least 50 percent native-born

Cuban workers, establishing a minimum wage for cutting sugar cane, creating a Department of Labor, and requiring compulsory arbitration of labor disputes. Although the Grau government was widely supported by the Cuban masses, it was not favored by business interests and Mr. Sumner Welles was strongly opposed to the administration. The refusal on the part of the United States to accord recognition to this government deprived it of an indispensable condition for success and after four months in office Grau found it desirable to resign.

5. Mendieta remained in power for two years, with the support of Batista and the United States Government

Carlos Mendieta, leader of the Nationalist Party which had opposed Machado, soon became Provisional President and was promptly recognized by the United States Government. As soon as he took office Roosevelt prohibited the export of arms and munitions to Cuba except on application for a license and approval by the Cuban government. Mendieta succeeded in obtaining a $4 million silver loan from the American Import-Export Bank and also negotiated a reciprocal trade agreement lowering duties on Cuban sugar and abrogating the obnoxious Platt Amendment. Despite the fact that economic conditions began to improve after 1934, political conditions within Cuba were disturbed throughout the latter part of 1934 and 1935. Agitation against both Mendieta and Batista was accompanied by strikes, sabotage and resorts to violence so Mendieta prepared to hold a delayed presidential election at the beginning of 1936.

Federico Laredo Bru the puppet executive under Batista 1936-1940:

The two chief candidates running for the presidency in 1936 were ex-President Menocal and Miguel Mariano Gomez. Gomez who was backed by the Nationalists and Liberals was elected President and was inaugurated on May 20, 1936. It is of interest to observe that he was the first Cuban President to be elected since 1924. Though he was an able man and desired to better the condition of the country, it soon became obvious that he also planned to reduce the size of the army and the influence of Batista. Batista responded by getting Congress to impeach Gomez and to remove him from office in December 1936. Federico Laredo Bru, the Vice President, then became President of Cuba and served as the puppet executive under Batista until July 1940.

Batista visited the United States in the spring of 1939, where he received a very cordial reception from American officials and was allowed to inspect American military preparedness. He has a fair degree of popular support in Cuba and has taken certain steps to better the condition of the lower classes. Of humble origin himself, he is reputedly liberal in his outlook and is regarded by some observers as having Leftist tendencies. He maintains his influence by virtue of the fact that he is supported by the army and hence is interested in strengthening its influence within the country. One of the main disagreements between Batista and Gomez concerned the influence of the military in Cuban elementary schools, Gomez contending that Batista

was trying to militarize the nation through control of the educational institutions. As long as he receives the support of the armed forces and the United States Government there is little doubt but what his position is fairly secure.

6. Fulgencio Batista elected President of Cuba July 14, 1940

The election was originally scheduled to be held in May and was postponed. Batista was opposed by the Grau San Martin factors. Both candidates pledged close collaboration with the United States, and guarantees to foreign capital. Batista has virtually ruled Cuba as Chief of Staff of the Army. During this seven-year period, eight Presidents held office only at his convenience. Batista's Government has been corrupt and dictatorial--political morality is at a dangerously low level and there is no immediate prospect for improvement. Under a new constitution promulgated in October 1940 the Government is democratic in form with provisions for ministerial responsibility to the Legislature consisting of a House of Representatives and a Senate.

The Government is made up of the following:

Vice-President	Dr. Gustavo Cuervo Rubio
Prime Minister	Dr. Ramon Zaydin
State	Dr. Jose Augustin Martinez
Presidency	Ing. Amadeo Lopez Castro
Finance	Dr. Jose Miguel Irisarri
Interior	Dr. Antonio Bravo Acosta
Justice	Dr. Federico Laredo Bru
Agriculture	Dr. Sergio M. Valdes Alba

Public Works	Ing. Evelio Govantes
Labor	Dr. Jose Suarez Rivas
Education	Dr. Ruben Daria Rodriguez
Communications	Dr. Marino Lopez Blanco
Health	Dr. Juan Miguel Portundo Domenech
Defense	Dr. Aristides Sosa de Quesada
Commerce	Dr. Wilfredo Albanes
Ministers without portfolio	Dr. Andres Domingo Morales del Castillo, Dra. Maria Gomez Carbonell, Dr. Gustavo Gutierrez y Dr. Rafael Santos Jiminez

7. Batista's Rise to Power.

Batista in 1933 led the Army in revolt against de Cespedes, provisional President and successor to the despotic Machado dictatorship of 1925-1933. Batista gained control of the army in September, and ousted his superior officers. From 1933 Cuba was governed successively by a Junta and eight presidents each of whom ruled at the will of Batista. He made and unmade presidents on the principle that he was the strong man of Cuba and that no other individual must be allowed to share the Cuban Government with him. Once the Army was under his thumb, he gave the army control over the schools, the Customs Houses, Public Works, Health, Labor, and Interior Departments. Batista formulated a Three-Year Plan in July 1937 and issued it through his puppet President Bru under the slogan "Cuba for Cubans." This program was aimed at foreign investors and sought to regiment civilian life. But the plan was suspended in May 1938.

Batista, though de facto ruler of Cuba since 1933, did not accept the Presidency of the Republic before 1940 because he feared the United States would not recognize his regime. The 1940 election was carefully timed so that Batista would secure the support of the strong Socialist-Democratic coalition made up as follows: The Labor, the Union Nacionalista, the Conjunto Nacional Democratico, the Democrata Republicano, the Popular Cubano, the Nacional Revolucionario (Realistas) and the Union Revolucionario Comunista. Thus his support ran the gamut from extreme right to extreme left. He gave the Communist Party legal recognition in order to secure its support in the election. The opposition bloc, composed of the Partido Revolucionario Cubano, the ABC, and the Partido Accion Republicano, nominated Dr. Ramon Grau San Martin for President.

8. Recent Political Events.

(a) A new constitution was promulgated in October 1940 but it has never been put fully into effect. Up to that time the Government functioned under constitutional decree laws issued by the Executive in 1934 and 1935. The new constitution, drafted by a Constituent Assembly, provided for a four-year presidential term of office, election by direct popular male and female vote, compulsory voting, and a responsible ministry type of Government. Social reforms such as minimum wage, maximum hour, and unemployment insurance were also included in the constitution.

(b) On December 17, 1941, Congress granted broad war powers to the Cabinet for 45 days and appointed a Commission of 20 Congressional members to keep in touch with the Cabinet. On

February 9, Congress approved the decrees that Batista and his Cabinet had issued and granted him broad powers over taxes, army reorganization, communications and transportation, commerce, industry and agriculture, and also gave him the power to make treaties with other nations.

(c) Later in February 1942 Cuba was threatened by a revolution led by army leaders who were dissatisfied with Batista as a result of his attempt to remove the control which the Army had over civilian departments. Batista intervened before the revolution could get under way, exiled the Chiefs of the Army, Navy, and police force, and secured an oath of loyalty from the army.

(d) In the spring and summer of 1942 there were several political crises. The Legislature was dissatisfied with the Cabinet's handling of patronage and attempted to remove the Cabinet, but was forced to pass laws which limited its powers over the Cabinet. Nevertheless, the Legislature adopted obstructionist tactics and forced Batista to reorganize the Cabinet. Widespread discontent arising out of wartime hardships led Batista to attempt to gain the support of the two Opposition parties, but he was unsuccessful in this effort.

Recent reports indicate that Batista has again attempted to bring the opposition parties into the Cabinet. "Revolucionario Cubano" headed by ex-President Dr. Ramon Grau San Martin, has heretofore refused to cooperate with the Government on any of its policies. Dr. Joaquin Martinez, head of the "ABC", has cooperated

with the Government but refused to enter the Government up to this time. The first actual signs of forthcoming Cabinet shifts took place on January 6, 1943, when the Minister of Education, Ramon Vasconcelos, resigned from the Cabinet and the Under Secretary was appointed to the post. It is expected that the ABC opposition will agree to enter the Government in the near future.

(e) Cuba's relations with Spain have become strained as a result of the reorganization of a strong, politically active Falangist movement by the Spanish Consul General. Cuba threatened to break relations with Spain on August 19, 1942, if Spain aided the Axis countries and Spanish diplomats were prohibited from using code in cables and postal communications or from using the diplomatic pouch.

(f) Early in 1941, a resolution was introduced in the United States congress which would have enabled Cuba to become a state in the United States. This resulted in violent demonstrations against the United States in Cuba. The Secretaries of State of both the United States and Cuba denounced the resolution.

(g) Batista's attempt to control the radio was denounced by the Opposition and resulted in street brawls by members of the Legislature.

(h) In November the Cuban Government established diplomatic and commercial relations with the Soviet Union. Thus Cuba was the first of the Latin American Governments to take this action.

PART IV

IV. Natural Resources and Foreign Investments

1. Area and Population

Cuba is about the size of the State of Virginia, totaling 44,000 square miles. The climate is mild and tropical, and the terrain consists of much fertile farm land, some mountains, forests and upland grazing land. Cuba has 2,200 miles of road (800 miles of which are in first-class condition) and 9,000 miles of railroad, more than half of which are owned by and run for private industrial concerns. Both highway and railroad transportation are hindered by shortages of fuel at present.

The population of Cuba is 4 million, most of whom are engaged in agricultural pursuits. The language spoken is Spanish although English is widely understood. The modal income for lower class families ranges between $350 and $400 per year. The population consists chiefly of white Cubans (2 million), colored or mixed Cubans, and Spaniards. There are approximately 13,000 Americans in Cuba excluding the armed forces. The country is chiefly Catholic.

2. Economic Resources

Cuba's economic welfare depends upon the production of sugar which, in its various forms, constitutes approximately 80 percent of the value of total exports. Tobacco is the next most important agricultural product, accounting before the war for about 8 percent of total exports. Diversification

of Cuban agricultural production and exportation is one of the Island's greatest problems.

Mineral production includes manganese ore, chromite, copper and iron ore. Ninety percent of the large iron ore reserves are owned by American oil interests. Cuba lacks coal, oil and waterpower, however, Cuba is dependent on imports for most manufactured goods as well as many foods, including the staple rice.

Tourists' expenditures were an important source of income before the war, amounting to between $8 and $15 million per year.

3. Foreign Investment in Cuba

Cuba's economic development has been based primarily upon foreign investment which, in the early thirties, were estimated at $1.25 billion. The present value of these investments is probably appreciably less than this.

American investments are estimated at about $650 million, as compared with about $150 million of British and Spanish investments. Of the $650 million, $560 million are direct and the remainder portfolio investments, in Cuban Government bonds.

About $240 million of the U.S. total has been invested in the sugar industry and roughly $100 million each in public utilities and public railroads.

COMMENTS BY

AMERICAN TECHNICAL MISSION TO CUBA

ON MEMORANDUM SUBMITTED BY

MR. W. R. BURGESS

OF THE

NATIONAL CITY BANK OF NEW YORK

The American Technical Mission to Cuba in the following pages has commented briefly on the objectives to its Second Report which were raised in a memorandum presented to Mr. Sumner Welles by Messrs. W. R. Burgess and W. W. Lancaster of the National City Bank of New York. These comments are presented in the same order and under the same headings as in the Burgess memorandum.

I. Soundness of the Bank

1. Taking over Cuban peso currency.

The Burgess memorandum urges that the silver certificates outstanding in Cuba when the Central Bank begins operation should be left as obligations of the Government. The Mission attaches little importance to the question of whether the Government should retain the liability for outstanding silver certificates or should transfer this liability, together with the corresponding asset in gold or silver coin, to the Central Bank. The Burgess memorandum, however, suggests that the solvency of the Central Bank would be endangered if the transfer were made. This definitely would not be the case. Silver certificates are redeemable only in silver coin. The Bank would obtain silver coin or

gold from the Government exactly equal in monetary value to the silver certificates for which it assumed liability. It would be in position to meet all demands for redemption.

Since the Cuban public, however, finds peso notes more convenient to use than 1-peso coins, there is little reason to anticipate much redemption of silver certificates. It is more likely that the certificates will disappear from circulation by the process of exchanging worn certificates for fresh Central Bank notes. This, as the Burgess memorandum points out, would involve an issue of banknotes without specific reserves, for the Mission has recommended that no gold or foreign exchange reserves be required against the silver certificates and 1-peso coin outstanding when the Bank begins business and this principle applies also to the banknotes issued to replace them. Only increases in Cuban currency outstanding (and Central Bank deposits) are to be limited by reserve requirements.

There is, of course, no danger to the solvency of the Bank in issuing reserve-free notes to replace silver certificates. They are full legal tender in themselves. Hence they cannot possibly create a liability which the Bank will be unable to meet.

This fact that the Bank's solvency would in no way be endangered by the issue of its legal-tender notes should not, however, be misunderstood. It does not mean that continuous and excessive issues of currency would be safe for Cuba. On the contrary, excessive issues would

be inflationary and a danger to the country's economy. But the inflationary effects of bank-note issues of this sort will be precisely the same whether the silver certificates outstanding are a liability of the Government or of the Bank. There will be the same amount of currency in circulation and the same amount of gold and foreign exchange reserves in Cuba in either case. Leaving the liability with the Cuban Government does not lessen in any way the danger of inflation in Cuba.

In suggesting that the Bank take over the liability for silver certificates, the Mission was moved by several considerations. It felt that it would be desirable to replace those certificates with Central Bank notes as rapidly as possible so that Cuba would have a uniform currency. It seemed likely that if the responsibility for silver certificates were transferred to the Central Bank with a view to their gradual replacement by Central Bank notes, the Government would be under less temptation to issue additional silver certificates to meet future budget deficits. There would also be greater economy if only one form of currency had to be engraved and kept in supply. Furthermore, retirement of the silver certificates would set free the silver held for their redemption and permit it to be put to more constructive use.

None of these considerations are, however, compelling; and if those who have had longer experience with the psychology of the Cuban public believe that confidence in the Bank would be materially strengthened by maintaining the existing issue of silver certificates as a liability

of the Government, the Mission would not be disposed to contest this point.

It should be noted, however, that retention of the silver assets and liabilities by the Government would sharply reduce the total assets and liabilities originally contemplated for the Bank and might, therefore, involve a readjustment upward of the percentage limitation on loans to the proposed Agricultural Bank. At present such loans by the Central Bank cannot exceed 15 percent of its total assets.

2. Reserve requirements.

The Burgess memorandum recommends that the Central Bank should be required to hold reserves against both notes and deposits, and that the required reserves be no less than is customary with banks of issue. In the draft law prepared by the Cuban authorities after receiving the Mission's report, provision is made for reserves against both notes and deposits. This is one of the two possibilities suggested by the Mission, and the Mission has accepted the Cuban draft on this point without comment.

There are, of course, wide differences among legal requirements of central banks as regards character of the reserve, liabilities subject to reserve, and the ratio required. One of the resolutions adopted by the London Monetary and Economic Conference in 1933 proposed 25 percent as an appropriate minimum reserve ratio for central banks. Leading central bankers helped formulate the resolution. The central banks established subsequently in Argentina, Canada, and New Zealand were all required to maintain this ratio against both notes and deposits. In the

present Cuban draft of the Central Bank law 25 percent is required against all note and deposit liabilities of the Bank except notes issued to replace silver certificates and 1-peso coins already outstanding at the time the Bank begins business. Reasons for the Mission's recommendation respecting Central Bank reserve requirements are presented in the Second Report.

3. "Overdrafts" for Stabilization Fund.

The Burgess memorandum advises against use of the term "overdraft" for Fund obligations, which will constitute the reserves of the Central Bank, and urges that the gold and foreign exchange backing of these obligations be made clear. On page 55 of the Mission's Second Report, in the section on Central Bank reserves, there is the following statement: "The Mission recommends that the only legal reserves of the Central Bank be obligations of the Stabilization Fund secured 100 percent by gold or foreign exchange." The position of the Burgess memorandum and that of the Mission do not differ on this point.

In the section on Fund Financing the Mission used the word "overdraft" in describing the Fund's borrowing at the Central Bank because it indicated the general nature of the operation. The Fund is expected to draw upon the Central Bank as necessary to purchase gold and foreign exchange, putting these up as collateral for the overdraft. It is difficult to find a single word or term which is completely descriptive of the operation. The operation cannot properly be described by the word "certificate". The Fund is not empowered to issue money. It cannot

issue gold certificates as can our own Treasury for deposit at the Central Bank. The Cuban Central Bank can refuse to permit further overdrafts by the Fund and can even require the Fund to repay overdrafts already made. This is an important feature of the Central Bank's control over the domestic credit situation and it is essential to keep it clear that the Fund's obligation is not itself money.

The Mission agrees that the word "overdraft" fails to convey the right impression as applied to reserves in the Bank's balance sheet. Some such term as "Gold demand obligations of the Stabilization Fund" would be better since it would call attention to the fact that these obligations are secured 100 percent by gold, or by foreign exchange that is virtually the equivalent of gold.

4. Government subscription to capital surplus.

The Burgess memorandum approves the Mission's recommendation of a capital surplus of 3,000,000 pesos to be contributed by the Government but suggests that this contribution be made in cash rather than in Government securities or, if securities are used, that they be interest-bearing so that they can be sold without discount. The Mission recommended that the Government contribution of 3,000,000 pesos to capital surplus of the Bank should be in interest-free securities in order to avoid an immediate burden on the budget. It was felt that the Government's subscription of approximately 2,000,000 pesos in cash to the Bank's shares, which would yield no dividends, was as great a burden as could reasonably be placed upon the budget at this time--especially as Government capital would also

be needed for the proposed Agricultural Bank. The fact that the Government is the residual beneficiary of the Central Bank's earnings would not compensate the budget in the early years for cash or interest-bearing securities paid into the Bank's capital and surplus.

The interest-free securities contributed by the Government to capital surplus can be utilized by the Bank for open market purposes if necessary and, in event of liquidation, they afford protection to the creditors and stockholders of the Bank. As to the matter of selling such securities at a discount, the Mission recommended that the Government's contribution to surplus amount to 3,030,000 pesos to take account of a possible 1 percent discount (i.e., an annual rate of 4 percent) in the event the securities are sold. The law drafted by the Cuban officials has followed this recommendation.

If the Government could pay interest on the securities without unduly burdening its budget, it would, of course, assist the Central Bank to avoid a deficit, as the Burgess memorandum suggests. Whether the Cuban Government can reasonably be expected to assume this additional burden or whether it must limit its contribution to the basis suggested by the Mission is a matter which can best be judged by Cuban officials who are thoroughly familiar with the present and prospective budgetary situation. In a letter to the Finance Minister the Mission indicated that interest-bearing securities might be used provided the budgetary problem could be solved.

II. Protection of the Bank from Undue Political Influence

1. Management.

The Burgess memorandum suggests five changes in the Mission's recommendations concerning the Central Bank's management. The suggested changes are summarized below with brief explanations of the reasons for the Mission's recommendations in each case:

(a) The memorandum proposes that the Governor of the Bank should be required to be a man of tested financial experience and capacity. The Mission was of course not unmindful of the desirability that the Governor should possess financial experience and capacity, among other equally or perhaps more important qualities. However, the Mission felt that it could leave the matter to the discretion of the Cuban specialists who would draft the legislation. The draft law based upon the Mission's report, Title II, Chapter 8, Article 36, provides as follows: "The Governor . . . shall necessarily be one of acknowledged competency in the banking field." The Mission believes that this provision covers the suggestion in the Burgess memorandum.

(b) The memorandum proposes that the head of the Agricultural Bank should be left off the Board. Cuba is an agricultural country and the field of agricultural credit is one in which extensive future development seems desirable. Accordingly, the Mission expected that the proposed Agricultural Bank would properly be one of the institutions for whose welfare the Central Bank should feel a great deal of concern. In its forthcoming report on an agricultural bank, the Mission plans to

recommend that both the Governor of the Central Bank and the Minister of Finance be on the Agricultural Bank's Board of Directors. To a considerable extent, the true welfare of the Agricultural Bank will be synonymous with the public welfare of Cuba.

It is true that the Agricultural Bank may become an extensive user of Central Bank credit. This fact, however, seemed no more a reason for excluding the Governor of the Agricultural Bank from the Board of Directors of the Central Bank than was the fact that commercial banks would also be prospective users of Central Bank credit a reason for excluding commercial bankers from the Board of Directors of the Central Bank. The Mission made what seems to be the fair assumption that the head of the Agricultural Bank, as well as commercial bankers who became directors of the Central Bank, could choose policies which were to the long-run advantage of Cuba rather than to the temporary advantage of their respective institutions.

The close association between the head of the Agricultural Bank and the other directors was looked upon as a potential source of considerable benefit both to the Agricultural Bank and to the other directors of the Central Bank. Statutory provisions placing the head of the Agricultural Bank on the Central Bank's directorship, and vice versa, seemed an appropriate method of bringing together persons jointly responsible for meeting a many-sided credit problem.

(c) The memorandum proposes that Class A directors should be increased to three or four so as to provide for the continuous place on

the Board of a representative of the United States branch banks in Cuba, and further recommends that the Class A directors be elected by the stockholding banks.

The Mission recommended that the banks in Cuba have an important voice in choosing two out of the seven members of the Board of Directors. It was felt that three or more members engaged directly in commercial banking on a seven-man Board of Directors of the Central Bank would give an undesirably heavy weight to the commercial banks. On the other hand, it was thought undesirable to enlarge the Board of the Cuban Central Bank to nine, eleven, or more members.

The Mission did not consider it appropriate to insist that any special representation be made on the Board of Directors for the United States banks as against the Canadian banks. It was felt important to assure that Cuban banks be given some place on the Board of Directors of the Cuban Central Bank. Further development of Cuban banking was regarded as one of the important objectives of the Central Bank. A number of foreign bankers in Cuba, in interviews with the Mission, expressed their opinion that such development was strongly desirable not only from the point of view of Cuba but also from the point of view of the foreign banks in Cuba.

It will be remembered that in the United States and Canada banks as such have no voice in electing members of the Board of Governors of the Federal Reserve System and directors of the Bank of Canada respectively. It is the Board of Governors, rather than the boards of directors of the separate Federal Reserve Banks, which is more nearly to be compared with

the Board of Directors of the Cuban Central Bank. Even on the boards of directors of the Federal Reserve Banks only one-third are persons engaged directly in banking. The Board of Governors of the Federal Reserve System is appointed solely by the President, with the approval of the Senate.

The Mission's recommendation regarding the selection of banking representatives was that the President of the Republic should name Class A directors from panels nominated by the banks in Cuba. It was believed that this would help to emphasize the national character of the director's function; and would diminish the danger that banking representatives might regard themselves as primarily the spokesmen of private banking interests.

The Cuban draft of the Central Banking law follows the recommendation of the Burgess memorandum in part in that it has Class A directors chosen directly by the banks holding stock in the Central Bank. Though preferring its original recommendation, the Mission raised no objection.

(d) The memorandum proposes that the Class B directors should be required to be selected for competency and experience in business and agriculture. This is similar to the Mission's recommendation and the provision in the Cuban draft law (Title II, Chapter 5, Article 22) that Class B counselors shall be chosen by "the President of the Republic from among persons of acknowledged experience in the several economic activities of Cuba". The Mission would be reluctant, however, to see this provision interpreted so narrowly as to exclude, say, an economist or lawyer who had gained a broad understanding of agriculture and business without directly engaging in them.

(e) The memorandum suggests that a Deputy Governor or General Manager of tested banking experience might well be included in the Charter as in many other central banks. The Mission did not consider it appropriate to include matters of this degree of detail in its report but relied upon Cuban specialists entrusted with drafting the law project to supply these provisions when necessary. The draft law provides (Title II, Chapter 8, Article 37) that: "The Vice Governor shall . . . necessarily be . . . of acknowledged competency in the banking field."

2. Advisory Council.

The Burgess memorandum recommends that Cabinet officers be debarred from membership in the Advisory Council. The conception of the functions of the Advisory Council inherent in the change recommended by the memorandum does not commend itself to the Mission as preferable to its own conception of the proper functions of this Council. The recommendation made in the Burgess memorandum seems to copy the composition and function of the Federal Advisory Council in the United States. This American Council is intended to bring the views of business from the widely scattered and different regions of the United States to the attention of the Board of Governors of the Federal Reserve System, who are full-time officers stationed in Washington. The Board of Directors of the Cuban Central Bank, however, includes two banking representatives who will presumably be currently engaged in banking and two representatives familiar with the problems of business and agriculture. Unlike the Board of Governors in the United States these four representatives of banking, business, and

agriculture will not be full-time salaried officers of the Bank. The functions of the Advisory Council as recommended by the memorandum thus seems to be furnished directly to the Central Bank in the persons of the Class A and Class B councillors. To compose the Advisory Council in the same way would merely be to duplicate the representation of banking, business, and agriculture.

As recommended by the Mission, the Advisory Council would give the Central Bank the benefit of consultation and advice from important Cabinet officers and leading men from private life. It was thought that the Cabinet members would be valuable advisors to the Central Bank because of their close association with the needs of the Cuban public in general. It was desired that the Council should supply a frequent interchange of views between the Central Bank and leading Cabinet members, as well as with the other members of the Council. Both the Bank and the Advisory Council were expected to benefit from this interchange. Furthermore, it was desired to have a Council that would prevailingly represent the Government to exercise the few emergency powers which the Mission recommended that the Council should have. It was definitely not the intention of the Mission that the Council should represent the advise exclusively of "men of business and banking experience". Rather it was intended that the Council should represent the broadest possible cross-section of the public as a whole and the best possible representation of the public welfare.

3. Advances to Government or Government agencies.

The safeguards proposed in the Second Report to limit advances to the Government are approved by the Burgess memorandum. As to the limitations recommended on loans to official credit institutions the Burgess memorandum observes that such loans are "properly limited" to 15 percent of the Bank's assets, but states that there should also be a limit on the total loans made by the Bank to all such credit institutions of perhaps 30 percent. The Mission had not thought it necessary to recommend any additional safeguard at this time when no such agencies exist. However, there would be no objection and there might possibly be some advantages to a limit on total advances or loans to all official credit institutions. Thirty percent may be somewhat low for such a limitation; possibly 40 percent would better fit the practical needs of the situation as it may develop in the future.

The Burgess memorandum also states that, in connection with loans to official credit institutions the phrase "short-term" should be defined. It does not seem wise to write into the Central Bank Law any specific provisions as to maturity for advances or loans to official credit institutions since no such institutions exist and since, therefore, it is impossible to foresee exactly what the appropriate maturities should be. In its forthcoming report on an agricultural bank, the Mission will make specific recommendations as to the maturity of the advances and loans which the Central Bank might make to the Agricultural Bank.

The Burgess memorandum further proposes that all advances by the Central Bank to the Government should be in the form of negotiable securities which would give the Bank better control over such advances in accordance with recognized Central Banking practice. The Mission believes that it would be helpful to have extensions of Central Bank credit to the Government largely take the form of short-term securities suitable for open market operations.

4. Profits.

The Burgess memorandum warns that permitting the Government to share in the profits of the Central Bank may cause the Government to bring pressure on the Bank to use its resources so as to maintain profits. To avoid this, the memorandum proposes a requirement that profits be used for the retirement of silver certificates or the capital surplus, or to pay interest on Stabilization Fund notes when and if they are sold to the public.

Inasmuch as the Government is a principal shareholder in the Bank and must contribute a considerable portion of the Bank's capital, it did not seem appropriate to the Mission to prevent residual profits to the Government after dividends have been paid to the banks and liberal transfers to special reserves and surplus have been made. Nor did it seem necessary to restrict the use to which the Government might put such funds. It is not reasonable to assume that any responsible Government would imperil the credit policy which the central bank was endeavoring to maintain in the interest of the entire country by putting pressure

on the central bank to operate so as to increase the annual earnings which the government would receive from the bank. Such a contingency is particularly unlikely when account is taken of the fact that the Central Bank's earnings could never amount to more than an extremely small proportion of the Government's total revenues.

As to the memorandum's proposal that the Central Bank should receive proper reimbursement from the Government for the performance of various fiscal agency operations, the Mission of course assumed that this would be the case. The law drafted by the Cuban Government provides for such reimbursement in Title II, Chapter 8, Article 41.

III. Effects on the U. S. Branch Banks

2. Direct loans by the Central Bank.

The Burgess memorandum argues that direct loans by the Central Bank to individual borrowers might subject the commercial banks to ruinous competition. The American Technical Mission to Cuba pointed out in its Second Report that private lending agencies should not be subjected to direct competition from a central bank because a central bank normally possesses certain advantages such as monopoly of note issue, possession of other bank's reserves, and partial tax exemption. The Technical Mission was also at pains to point out that a central bank should be permitted to make direct loans to the public only in extreme emergencies when commercial banks are being subjected to drains and are, therefore, forced to call in old loans and refuse new ones against their wishes. During such a period, it may be important to have a banking agency in a

position to make loans to prevent ruinous credit contraction in the business community. The Mission therefore recommended that in such emergencies the Central Bank be permitted to make direct loans but safeguarded the commercial banks by requiring a proclamation of the President of the Republic (possibly with the consent of the Senate) explicitly recognizing such an emergency to exist and by requiring an affirmative vote of five Directors on all such loans.

The Burgess memorandum suggests, first, that the safeguards proposed by the Mission should be written into law. This accords with the Mission's report. Second, the memorandum proposes that the affirmative vote of six rather than five directors be required for the approval of direct loans. The Mission is still of the opinion that requiring the approval of five out of seven directors constitutes ample safeguard of the commercial banks' interests (in conjunction with the other safeguards proposed). Requiring the affirmative vote of six directors would give veto power to the Class A directors in carrying out the Central Bank's credit policy during a period of emergency - a policy which would be of vital concern to the entire country. Under the Mission's recommendation, the negative vote of only one director in addition to the Class A directors can block a proposed direct loan.

Third, the Burgess memorandum suggests that direct loans be made only at some rate substantially above the Central Bank's regular discount rate. The Mission originally felt that the question of the rate could safely be left to the Bank's discretion. If the commercial banks

operating in Cuba regard the specification of a minimum interest rate on direct loans as a substantial protection to their interests, the Mission perceives no objection to the imposition of a reasonable minimum above the Bank's rediscount rate.

3. Power to change reserve requirements of member banks.

The Burgess memorandum states that the Mission's report gives the Central Bank power to change reserve requirements of banks but does not suggest within what limits; that the Federal Reserve Act fixes a maximum of 26 percent, while Cuba is to begin at 20 percent in the Central Bank; and that a requirement much higher than this would make profitable operation almost impossible.

This statement of the matter appears to overlook the very material limitations which the Mission recommended be placed upon the power of the Central Bank to raise reserve requirements. The most important of these was that the higher reserve requirement ratio should apply only to demand deposits in excess of those held by each bank at the time the increase is ordered. Under the Federal Reserve Act any increase in reserve requirements applies thereafter to all deposits of member banks, regardless of when received, whereas in Cuba under the recommended limitation the increased requirements would operate only in case of a growth of deposits above the amount held at the time of the increased requirements and then only with respect to the excess. Since the two methods are so essentially different, the maximum percentage in the United States

would seem to have little significance in considering the merits of the recommendation for Cuba.

In view of this limitation recommended by the Mission, it is believed that the effect of increased reserve requirements upon bank profits is greatly over-emphasized. Further, the report of the Mission suggested in this connection that the banks be permitted to levy charges on bank depositors sufficient to cover the costs of maintaining checking services, including among the costs a fair profit on the banks' capital in Cuba; and it is believed that by making such charges (which have become customary in the United States with the decline in earnings from investments) the banks could largely offset any decrease in earnings resulting from increased reserve requirements. Moreover, it is to be expected that the Central Bank in taking any action with respect to reserve requirements would consider all factors involved, including any decrease in earnings of the banks.

It is the opinion of the Mission that the Central Bank in Cuba should have this authority in order that the expansion of bank loans and investments may be restricted when circumstances make this advisable.

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AMERICAN TECHNICAL MISSION TO CUBA

THE CENTRAL BANK AND STABILIZATION FUND

SECOND REPORT TO THE CUBAN GOVERMENT

APRIL 22, 1942

IMPRENTA
P. FERNANDEZ Y CIA.
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PERSONNEL OF MISSION

G. A. EDDY
Treasury Department

A. T. ESGATE
Farm Credit Administration

W. R. GARDNER
Board of Governors of the Federal Reserve System

F. A. SOUTHARD, Jr.
Treasury Department

H. R. SPIEGEL
Treasury Department

G. B. VEST
Board of Governors of the Federal Reserve System

H. D. WHITE
Chief of Mission, Treasury Department

AMERICAN TECHNICAL MISSION
TO CUBA

April 22, 1942.

Dear Mr. Minister:

The American Technical Mission to Cuba was organized by the United States Government at the request of the Cuban Government in September 1941 *to study Cuban monetary and credit problems and to make such recommendations as seemed appropriate. The Mission, as you know, spent a number of weeks in Cuba studying material made available to it and interviewing Government officials, bankers, businessmen, representatives of trade associations and other persons familiar with Cuban banking and credit needs. The Mission submitted its first report in November* 1941.

I am herewith submitting to you for the consideration of your Government the second report of the

Mission, dealing with the establishment of a Central Bank and the reconstitution of the Cuban Stabilization Fund. The completion of this report has been delayed owing to the fact that the outbreak of war has made it impossible for the members of the Mission to devote as much time to the report as they had expected. The Mission prepared its report in analytical form because it felt that this form would be more helpful to the Cuban Government than would a draft law.

The Mission would like to call attention to the contribution which many Cubans have made to this report. Many organizations and individuals generously contributed information and advice while the Mission was in Cuba. The Mission has also had at its disposal studies which officials of the Cuban Government have made on monetary and credit problems which were found to be very helpful.

Sincerely yours,

H. D. WHITE, Chief
American Technical Mision to Cuba.

Honorable Oscar Garcia Montes,
Minister of Finance,
Havana, Cuba.

INTRODUCTION

The Mission began its work with the realization that Cuban monetary and credit problems differ materially from those in the United States and that it is essential to devise and recommend a program suited to Cuba's special conditions. The Mission therefore has studied the existing Cuban monetary and credit organization and practice in order to provide a factual background against which to formulate its recommendations. What seem to be among Cuba's principal problems in the fields of money, foreign exchange, and bank credit are summarized briefly below so that the recommendations contained in the body of the report may appear in their proper setting.

CUBA'S DEPENDENCE UPON DOLLAR CURRENCY AND FOREIGN BANKS

For ever 40 years the United States dollar has been legal tender in Cuba. Until recently dollar currency and dollar deposits have been the principal medium of exchange. Since the closing of three large Cuban banks in the depression following the

last war, branch offices of United States and Canadian banks have handled most of Cuba's banking business. Cuba has been to a large extent an appendage of the United States dollar monetary system.

This status had some undoubted advantages. The money of Cuba, being dollars, could not depreciate in terms of the money of the United States, with which most of Cuba's trade took place. The branches of the United States and Canadian banks were exceptionally strong. Moreover, additional bank credit could be made available from the head offices whenever the branches felt that there was a good opportunity for additional loans.

DISADVANTAGES OF AN ALL-DOLLAR SYSTEM

Against these advantages, however, there have been several disadvantages, the importance of which may have increased considerably since 1929.

1. LACK OF CENTRAL CONTROL OVER BANK CREDIT

Since a Cuban bank of issue could not have issued United States dollars, Cuba's retention of dollars as its chief form of money made the establishment of a Cuban Central Bank virtually impossible. No Cuban authority could be charged with responsability for the adequacy of, or given remedial powers over,

the volume of currency and bank credit in Cuba. The total quantity of currency, deposits, and bank loans in Cuba tended to be the resultant of the balance of international payments and the foreign banks' judgment of the risks of potential bank loans. These are sometimes (though not always) undesirable regulators of a nation's supply of money and credit and could hardly prove a satisfactory arrangement for a mature country. Many of the bankers themselves have regretted the situation, since, while they were interested primarily in certain types of banking business, almost all the country's credit needs devolved upon the foreign banks.

2. ABSENCE OF REDISCOUNT FACILITIES

There have likewise been no Central Bank rediscounting facilities in Cuba to which banks could turn when in need of additional currency or lending capacity after their own loanable funds were fully utilized. Although the foreign branch banks could draw upon their home offices when they wished to, Cuban-owned banks have had to rely upon their own resources or borrow either from competitors or from banks abroad.

3. RETARDED DEVELOPMENT OF CUBAN-OWNED BANKS

This lack of rediscounting facilities has doubtless been one of the factors retarding the development of Cuban-owned banks. There are today only four such banks, of which three are relatively small, and of which the combined deposits are less than 20 percent of the total deposits in Cuba.

4. ECONOMIC COST OF DOLLAR CURRENCY

Use of any foreign currency as a domestic medium of exchange involves a substantial cost to a nation's economy. For Cuba the use of dollar currency is fully as costly as if its entire stock of domestic hand-to-hand currency consisted of gold coin purchased abroad at its full monetary value. In modern monetary systems it has become accepted practice to use as domestic means of payment (in addition to bank deposits) notes or coins the intrinsic value of which is far below their monetary value. They may, however, be secured in part by valuable metallic or foreign exchange reserves. If the dollar currency in Cuban circulation were replaced by an issue of Cuban currency, the dollars could enter an official exchange reserve which, to the extent that they were not required as a reserve for the newly issued Cuban currency, would be available to the Cuban economy for financing imports, repaying

foreign indebtedness, and the like. By using dollar currency internally, Cuba has postponed use of (but not lost) the opportunity to import more machinery, other productive equipment, or consumption goods, to liquidate foreign debts, or to make investments abroad.

During certain periods, futhermore, a loss to the Cuban economy may have been involved in some (but by no means all) of the dollar deposits in banks in Cuba against which the banks hold dollar balances abroad or other foreign assets.

It may be remarked, however, that the economic cost of using dollars in Cuba does not mean that foreign nations or foreign banks have been taking unfair advantage of Cuba. The foreign investments made in Cuba exceed the total imports of dollars many times over. Cuba on balance has received from abroad far more than she has sacrificed by using dollars as domestic money.

TRANSITION TO PESO CURRENCY AND DEPOSITS

Several acts and decree laws in the years 1932-38 ordered the coinage of specified quantities of silver pesos. This marked the first important breach in the use of dollars in Cuba. The purchase of silver at the market price and its issuance as money (almost entirely as silver certificates secured peso for

peso by coins) at the same monetary value as the United States silver dollar gave rise to important seigniorage profits, which covered part of the Government's expenses during those troubled years of Cuban history. As early as 1939 peso silver certificates had almost entirely replaced dollar currency in public circulation, and about half of the bank deposits were denominated in pesos.

Banks maintain almost fully covered positions in both currencies at all times. That is, they maintain their peso assets equal to their peso liabilities and their dollar assets equal to their dollar liabilities. To do otherwise would expose them to risks of fluctuations in the rate of exchange between dollars and pesos.

DISADVANTAGES OF COMBINED PESO-DOLLAR SYSTEM

Cuba has made considerable progress away from the dollar system which formerly prevailed, nevertheless, the present mixed system also contains several pronounced shortcomings.

1. ABSENCE OF PESO REDISCOUNTING AND CURRENCY ISSUING MECHANISM

There being still no Central Bank, there is still no "lender of last resort" or bank of issue where banks can obtain additional peso currency or peso lending power when needed. At times there has been considerable

stringency of peso lending power. Since certain types of loans are now normally made only in pesos (as a result of the law of July 8, 1939, for which see Section VI), this has been an added difficulty for certain types of potential borrowers.

2. INADEQUATE FOREIGN EXCHANGE STABILIZATION OF THE PESO

The development of peso currency and deposits has not included the acquisition of an official store of international monetary reserves by use of which the value of the peso in foreign exchange markets can be supported. The principal type of such reserves which the Cuban Government now holds and could employ for this purpose is its store of silver, which might be sold abroad at the market price for silver bullion, far below its statutory peso value. This silver can be made available for export, however, only by retiring the peso silver certificates against which the coined silver is held as security.

For some time after the appearance of the first issues of peso currency, the Cuban balance of payments (supplemented by some export of dollars replaced by the new pesos) sufficed to keep the peso close to parity with the dollar. In 1938 and still more in 1939, however, the balance turned against the peso. As already stated, Cuba had no official

agency with resources acceptable in the settlement of international balances. Consequently the value of the peso declined in terms of other currencies until the lower rate was sufficient to restore balance between the payments into pesos and payments out of pesos. Transfers out of pesos were no doubt increased by fears of still further depreciation.

Since then the balance of inter-currency payments has carried the peso exchange rate back to par with the dollar and even above. Only the legal tender equality of dollars and pesos in Cuba has prevented the peso from going to a considerable premium. The right to import dollars to make peso payments has kept the rate down. In the process many millions of dollars have again gone into general Cuban circulation. Were they acquired instead by an official agency charged with the responsability of stabilizing the foreign exchange value of the peso, this agency could give far more effective support to the peso, when necessary, than would a subsequent private re-export of the dollars.

Acquisition of a stock of imported gold or foreign exchange represents the same economic cost to Cuba as the import of dollars described above. To the extent necessary to build up a stock sufficient to give reasonable support to the peso during any future periods of adverse inter-currency payments, this cost is fully justified. Moreover, during the present

war, when many types of imports are not available and when its exports promise to be exceptionally large, Cuba may inevitably acquire a stock of gold or dollars representing the postponement of a greater amount of potential imports than has ever been involved in Cuba's use of dollar currency. Nevertheless, the fact remains that Cuba does not have an effective arrangement for stabilizing the foreign exchange value of the peso when the current balance of inter-currency payments turns against it.

3. EXPORTATION OF CUBAN SAVINGS

There is a strong tendency on the part of Cubans to keep savings and investments in dollars. Although in part these dollar savings may be invested in Cuba, they tend in part to become capital exports to the United States. This is, under ordinary circumstances, a severe drain upon the Cuban economy. Cuban prosperity under normal conditions will require extensive local investment of pesos annually.

WEAKENED DEMAND FOR MORTGAGES

The public's willingness to invest in Cuban mortgages is reported to have been shaken by moratorium legislation during the 1930's. The Mission was unable to explore this question extensively but testimony which it received pointed to the conclusion that this legislation has given rise to fear of similar legislation in subsequent periods of economic dif-

ficulty and in consequence seems to have restricted the supply of funds seeking investment in Cuban mortgages.

PAUCITY OF FACILITIES FOR GOVERNMENT BORROWING

The Government has faced almost insurmountable difficulties in borrowing money in Cuba. Inability to engage in irresponsible or uneconomic borrowing should not, of course, be regarded as a difficulty. There are, however, some circumstances under which a national Government and official credit agencies should be able to borrow. Moreover, domestic borrowing is frequently strongly preferable to incurring debts in a foreign currency. It seems clear that Cuba's potential well-being will be hampered unless on the one hand investors' confidence in obligations of the Cuban Government is thoroughly justified and unless on the other the Government and its agencies have facilities in Cuba for floating economically desirable loans.

ABSENCE OF SPECIAL LENDING INSTITUTIONS

There are almost no lending agencies in Cuba other than banks, and only a limited market for corporate securities. Other nations have developed special institutions to meet particular types of credit needs, such as agricultural loans, home loans, industrial loans, etc. Some of these institutions have required considerable Government support.

RECOMMENDATIONS

The American Technical Mission to Cuba recommends the establishment of a central bank and the reconstitution of the Cuban Exchange Stabilization Fund. A well-managed central bank and a stabilization fund with more adequate resources would be able to ameliorate a number of the conditions now prevailing in Cuba which were cited in the introduction.

The Mission, however, does not wish to encourage expectations that a central bank and a stabilization fund will accomplish more than is actually within their powers. The solution of many economic and financial difficulties far exceeds their capacity, no matter how skillfull the management. Such institutions have not been able to shield other countries

from severe economic maladjustments. Cuban conditions present special difficulties, and future events are sure to create new ones. Moreover, a poorly administered central bank or stabilization fund could add greatly to the difficulties that already exist.

Nevertheless, properly constituted and expertly managed, these institutions can provide that pooling and utilization of resources and that strong determination of policy which can furnish essential help to meet emergencies and be of important assistance in fostering economic development. Moreover, a good central bank is a prerequisite to many further measures to promote economic welfare. In the following recommendations the Mission has endeavored to set forth the characteristics of a central bank and stabilization fund which seem to it best calculated to meet the situation in Cuba. Superior management alone can assure the successful evolution of the institutions.

The detailed recommendations relating to the establishment of a central bank and reconstitution of the Cuban Stabilization Fund are presented on the following pages.

I. CAPITAL

AMOUNT OF CAPITALIZATION The needs of the proposed Central Bank for capital would appear to be met satisfactorily by an original subscription of 5 million pesos of paid-in cash subscriptions and 3 million pesos to be credited to capital surplus and to be paid for by Cuban Government securities. Additional shares should be authorized for subsequent cash sale to allow for future growth.

ITS ADEQUACY Eight million pesos of capital funds at the outset seems well within the means of the Government and the banks. At the same time it is a sufficient sum to serve the Central Bank's need for capital. The ratio between this capital and surplus and the Banks' prospective liabilities compares favorably with similar ratios found in other central banks. The

ratio between this capital and surplus and the Bank's prospective assets subject to possible depreciation is also favorable. This total of capital funds should give the Cuban public confidence in the solvency and soundness of their Central Bank while on the other hand avoiding over-capitalization. It should be possible for the Bank, under reasonably favorable circumstances, to earn enough to pay a fair return to its shareholders.

SOURCES AND RATES OF SUBSCRITIONS

An equitable means of raising this capital appears to be as follows: Each bank conducting a checking-account business in the Republic of Cuba will be required to subscribe an amount equal to 2 percent of its total deposits (both demand and savings) in some designated base period for shares designated as Class A, and the Government of the Republic will subscribe for enough additional shares designated as Class B to bring the total paid-in cash capital to 5 million pesos. In the event of any impairment of capital, Class A shares should be given preference over the Class B shares. At current deposit levels, the banks would subscribe about 3 million pesos and the Government about 2 million. As set forth in greater detail below, the Government will provide the capital surplus in its entirety.

THE BASIS FOR APPORTIONING BANKS SUBSCRIPTIONS

A word of explanation is perhaps necessary on basing bank's subscriptions on their deposits rather than on their capital as is the method in many other countries. A majority of the banks operating in Cuba are branches of large foreign banks and have in Cuba either a token capital or no separate capital whatever. Required bank subscriptions to stock of the Central Bank cannot appropriately be determined on the basis of such capitalizations. It would not appear to be to Cuba's interest to require that separate capital be provided for the Cuban branches of well-established, sound foreign banks. This is discussed further in a later section. There is obviously no need to require each bank to alter its present capitalization merely to provide a basis for compulsory subscriptions to Central Bank stock.

The deposits of a commercial bank are a fair measure of its size and importance. The Mission has therefore recommended that they be used as the basis for determining the subscription of each bank to shares of the Central Bank. It is reasonable that a bank's participation in the Central Bank should be roughly in proportion to its size and importance in the banking community.

Subscriptions equal to 2 percent of deposits are not an onerous burden on the banks; a lower rate would not yield a sufficiently substantial sum.

SUBSEQUENT ADJUSTMENT OF BANK HOLDINGS

As their deposits increase banks should periodically —probably once a year— be required to increase their holdings of the Central Bank's stock to equal 2 percent of their deposits averaged over the preceding year or some other practical period. Similarly, should there be a decrease in the deposits of a bank, there should be a corresponding reduction in its requirement to hold Central Bank shares, although it might well be provided that a bank would not be compelled to sell shares back to the Central Bank under these circumstances in case it wished to retain them.

Whenever commercial banks are required to purchase additional shares, it seems appropriate that the Government be permitted, at its discretion, to resell to the Central Bank a like number of its shares, which it had purchased for cash. In this way the paid-in capital stock would be maintained at least at 5 million pesos and the Government would continue to furnish all the capital funds subjected to greatest risk, namely, the capital surplus. In case the Government did not wish to sell its shares, or if all the Government's shares had been redistributed among the banks, the Central Bank would sell additional, hitherto unissued, shares as required. An initial authorization of 10 million pesos of stock should provide adequately for growth for a number of years.

Purchases of additional shares as well as redemption of shares held by commercial banks should be at par. It might be provided that transfer of shares should take place just after dividend dates, in order to avoid adjustments in price for unpaid dividends.

HOLDINGS OF BANKS IN LIQUIDATION

Provision should be made for the Bank to redeem upon reasonable notice any of its shares held by banks which desired to liquidate their Cuban business.

SAFETY OF BANKS' SUBSCRIPTIONS

Care should be taken to protect the banks against loss of principal on their subscriptions, since this would impair the assets covering their deposit liabilities to the public. It will be noted that no recommendation has been made for double liability of shareholders in the Central Bank, and there is no provision for unpaid subscriptions which could be called for payment at times which might be embarrassing. More important still, the Government is supplying a protective cushion upon which any losses will fall before impairing the shares

of the commercial banks. Initially this cushion will be approximately 5 million pesos, one and two-thirds times larger than the aggregate subscription of the banks. In fact, this initial amount of Government funds is larger than seems desirable once the Bank has been firmly established. It is made as large as it is only in order to furnish the Central Bank an ample initial amount of cash capital without burdening the commercial banks. As the deposits of the latter grow, it seems appropriate, as recommended above, that they should purchase some of the shares which the Government paid for in cash.

PAID-IN SURPLUS It seems desirable that there should be a substantial surplus, in addition to paid-in capital, at the time the Central Bank begins business. This surplus would serve several uses. First, it would contribute to the confidence of the public in the Central Bank in the early period of the Bank's existence. Second, it would, within the limit of its amount, permit the absorption of losses without impairment to the paid-in-capital of 5 million pesos. The Mission is therefore recommending a capital surplus of 3 million pesos.

In view of the role which the Government should play in the management of the Bank and in the dis-

tribution of the Bank's earnings, it is felt that the Government, rather than the commercial banks, should contribute the capital surplus. Further, the Mission recommends that if the capital surplus is reduced to 1 million pesos, the Government should restore it to 3 million pesos.

METHOD OF PAYMENT The initial and any subsequent contribution to capital surplus should be made by the Government's issuing special Treasury securities to the Central Bank. This method of contribution is well designed to meet the special circumstances in Cuba. It would reduce to a minimum the actual cash payment that the Government would have to make to the Central Bank and, at the same time, the Central Bank could have the full advantages of a capital surplus. It is not necessary that the surplus be paid in to the Central Bank in the form of cash.

The securities which the Government would turn over to the Central Bank as capital surplus could be used by the Central Bank in two ways. First, they would constitute sound assets able to make up any possible loss suffered on the Bank's other assets up to the extent of 3 million pesos without the impairment of the Bank's capital. Second, the Central Bank could use some of these securities for open-market operations if necessary.

FORM OF THE DELIVERED SECURITIES

The Mission recommends that these securities be Treasury bills bearing no interest and having no specified maturity but payable 90 days after sale by the Central Bank. The Bank would be able to sell these obligations when necessary at a discount which should be less than 1 percent. Upon their sale they would automatically become Treasury bills, payable in 90 days, sold on a discount basis as are Treasury bills in the United States and England. In order that the securities contributed by the Government for the capital surplus of the Bank may be adequate to produce 3 million pesos when and if sold on the market as indicated, it is recommended that the Government turn over to the Bank initially for this purpose securities with a face value of 3,030,000 pesos. With this amount of such securities on hand, a possible discount of 1 percent will be provided for, and the Bank may then show a capital surplus on its balance sheet of 3 million pesos.

Formal acknowledgment on the Bank's balance sheet of the Government's contribution of the capital surplus seems desirable.

SAVINGS BANKS

The existence of well-managed savings banks might be of considerable benefit to Cuba.

Should such banks develop or should savings banks be specially provided for in legislation, consideration should be given to making membership in the Central Bank available to them. Their growth and soundness would be enhanced if they were permitted, when occasion demanded, to obtain liquidity of sound assets at the Central Bank rather than by forced liquidation.

DIVIDENDS

It seems wise that the first claim upon the earnings of the Bank after providing for minimum reserves should be a moderate dividend for the shareholding banks. The rate might be limited to 3 or 4 percent, cumulative. Although this rate is lower than the maximum rate on Federal Reserve Bank stock in the United States, the latter rate was selected in 1913, when interest rates in the United States generally were much higher than today. Moreover, the United States Government did not subscribe to Federal Reserve Bank stock.

FURTHER DISPOSITION OF EARNINGS

After dividends to member banks, the Central Bank should pay residual earnings to the Treasury of the Republic. Such payments would be an appropriate method of compensating the Government for giving the Bank the monopoly of issuing currency notes and of holding bank's legal reserves, both

of which are properly privileges or responsibilities of the State, and also for the Government's subscription to capital and capital surplus. Residual earnings should be paid to the Government, however, only after building up some earned surplus out of which to meet expenses, losses, and dividends during adverse periods. Statement in the law of a formula for the disposition of surplus is therefore suggested, somewhat as follows:

FORMULA FOR BUILDING UP SURPLUS

At the discretion of the directors the Bank may build up earned surplus and reserves against anticipated losses without paying dividends, but dividends shall be cumulative and no earnings shall be paid to the Government so long as there are any dividend arrears. After payment of full dividends, the Bank's earnings shall be divided as follows:

> 50 percent to the Government and 50 percent to surplus till an earned surplus of 3.5 million pesos has been accumulated; 75 percent to the Government and 25 percent to surplus till an earned surplus of 7.0 million pesos has been accumulated; thereafter 100 percent to the Government.

In the event of liquidation of the Central Bank, any surplus after retiring stock held by banks at par plus dividends accrued and earned shall revert to the Government.

PROFITS NOT A MEASURE OF BANK'S VALUE

The Central Bank should not be operated primarily to obtain profits nor will its record of profits be an adequate measure either of the Bank's usefulness to Cuba or of its soundness as a financial institution. In its capacity as a bank of issue, as a regulator of credit, as a central reserve for banking funds and as a public depository, the benefits rendered by the Central Bank will be manifested in many direct and indirect ways quite apart from its annual distribution of dividends and profits. For this reason there is in the mind of the Mission a clear argument in favor of confining the Government's participation in the Bank's earnings to that of a receiver of those profits which remain after dividends have been paid to member banks and after adequate provision has been made for surplus and special reserves.

II. MANAGEMENT

BROAD OBJECTIVES IN CHOOSING MANAGEMENT

The Mission has studied with particular care the problem of the composition and method of selection of the management. On the one hand, it is the conviction of the Mission that the responsibility for the country's monetary and banking system and policies must rest primarily with the Government and that therefore at least a majority of the management should be selected by or approved by the Government. On the other hand, it is equally clear that there must be a satisfactory balance of representation, that members should have a sufficient tenure of office to provide for some continuity of experience, and that precautions should be taken to obtain competent and independent management. Above all,

it is of the utmost importance to establish a method likely to lead to the selection of the best available persons for management of the Bank.

THE BOARD OF DIRECTORS

Accordingly, the Mission recommends that control of the Central Bank should be placed in a board of directors composed and selected as follows:

The Governor of the Bank, to be selected by the President of the Republic.

The Minister of Finance, ex officio, or, at his discretion, an alternate designated by the Minister to serve for so long a time as the Minister may wish.

The head of the Agricultural Bank, ex officio, if such a Bank is created and is designed to have an officer appropriate to serve as director of the Central Bank. Until he shall be appointed, the place may be filled by a third Class B director (see below).

Two Class A directors, to be selected by the President of the Republic for their competence and experience in the field of banking, one from a panel nominated by the Cuban banks and one from a panel nominated by the foreign banks in Cuba.

Two Class B directors, to be selected by the President, in the light of their business or agricultural experience.

All directors should be chosen, not simply as representatives of special groups with which they may have been associated, but because of their competence and devotion to the general welfare, and in the light of their training and experience. The several directors should be selected with a view to obtain a board with broad experience in Cuba's various economic pursuits.

The Class A and Class B directors might be given staggered terms of two years each. Directors should be eligible for reappointment.

The Governor of the Bank should have a term of three to five years and should be eligible for reappointment.

It is recommended that the directors be paid only a modest compensation, per meeting, plus direct expenses. The salary of the Governor of the Bank should be stipulated by law. The Governor, the Finance Minister, and the head of the Agricultural Bank should receive no extra compensation for acting as members of the board except for any direct expenses incurred.

POWERS OF THE BOARD OF DIRECTORS

The duties of the board of directors should be stated in the broadest possible terms since the board is ultimately responsible for the management of the Bank. The board should be given responsibility for all major policy decisions. It should also be given powers to delegate authority to committees or officers of the Bank.

PLANS FOR A SUPERIOR BANKING COUNCIL

In the several studies of Cuban banking needs which have been made by the Cuban Government, there has been provision for a Superior Banking Council. It was proposed in these studies to provide this Council with power over the Central Bank in all major policy matters and even in many matters of detail concerning Central Bank operations.

The Mission has given careful consideration to the desirability of providing for a Council of this sort and is in sympathy with the objectives which it is hoped to reach through the function of a Superior Banking Council. However, to establish a Council with powers superior in all important respects to those of the Central Bank and staffed with full-time officers and employees, seems both undesirable and unnecessary, in conjunction with a Central Bank

such as is recommended in this report. It is undesirable first because it would place the Bank's board of directors in such a position of inferiority as to make it doubtful that well-qualified persons would accept membership on the board, and second because there would be uneconomical duplication of function and personnel between the Council and the Bank. The principal objectives sought through the Council are believed to be attained in the Mission's recommendations by other means.

THE ADVISORY COUNCIL ON MONETARY POLICY

Nevertheless, functions of considerable usefulness could be performed by a small advisory council of Government officials and others, acting mainly through occasional meeting and with indirect rather than direct powers over the Central Bank. The Mission therefore recommends the establishment of an Advisory Council on Monetary Policy, made up of the Ministers of Finance, Agriculture, Commerce, and Labor, and three others appointed by the President. Of the President's appointees, one might be selected from the faculty of the University of Havana, and one might be a man, either in Cuba or from abroad, who is experienced in central banking problems.

FUNCTIONS OF THE ADVISORY COUNCIL

The duties of the Council should primarily be to consult and advise with both the Government and the Bank on major matters of credit policy which particularly affect the public welfare. Ultimate responsibility for policies of the Central Bank should be left with the Bank's board of directors, but the Council would have the prerogative of making its views on policy known to the board whenever the Council desired, of requesting explanations from the Bank on its actions, and of calling attention to neglected problems, and would have certain duties indicated in a later section in regard to deficiencies in the Central Bank's required reserves.

At any time the Council should have the right to request that the Bank make an explanation in writing of any current policy. In addition, the Bank should be required to make an annual report to the President, with a copy to the Council, explaining all major policies carried out during the year and giving the reasons therefor.

MEETINGS OF STOCKHOLDERS

In view of the recommendations made above for selecting the management of the Bank, the functions remaining for action by the stockholders of the Bank as such are

relatively few. Meetings of the Central Bank's shareholders may be provided for to receive the annual report of earnings, discuss matters relating to the Bank, and attend to other technical requirements of the Bank's corporate existence. Furthermore, the panels for the selection of Class A directors might be selected by the member banks on the occasion of the annual meeting of shareholders.

III. LOANS AND INVESTMENTS

IMPORTANCE OF FUNCTION

The making of loans and investments is probably the most important single function of a central bank. It includes refusing unsafe, improper, or excessive loans and investments as well as making positive commitments with courage and discrimination; influence upon borrowers to improve the character of obligations which may be acquired by the bank; skillful timing of operations; and enlightened management of the total volume of its credit outstanding. The Cuban Central Bank will survive or fall, will benefit Cuba or leave it worse off than if the Bank had never been created, depending on the quality of the Bank's policies in this vital field.

The Central Bank will normally confine its loans to (or make its investments in the obligations of) banks, the Central Government itself, the Stabilization Fund, and any governmental credit institutions which may be created. Recommendations concerning these uses of central bank credit will be discussed in that order.

ACCOMMODATION TO BANKS Regarding accommodation to banks, it has been customary in central bank laws to define in considerable detail the credit instruments eligible for rediscount. Nevertheless, in the opinion of qualified observers the results of such detailed statutory definition in the United States have not been altogether satisfactory and have resulted in significant inflexibility of rediscounting operations, with few compensating advantages. The Mission therefore recommends that a broad and simple formula be written into the Cuban law to govern the Bank's selection of the credit instruments which it may consider for rediscount.

REDISCOUNTS Until the banks in Cuba shall have obtained some experience with central bank operations, it seems advisable to confine normal rediscounting to the better recognized types of self-liquidating, short-term credit instruments. To this end it should be

provided that the Central Bank may at its discretion rediscount self-liquidating obligations of a quality recognized as sound by the best banking standards bearing the name of at least one person or firm of proven responsibility and endorsed by a stockholding bank, with a maturity of not more than 120 days from the date of discount, or 180 days in the case of obligations issued for agricultural purposes.

ADVANCES The Bank should also have the power to make advances to stockholding banks secured by assets eligible for rediscount or purchase by the Central Bank, provided the advances have a maturity of not more than 90 days.

EMERGENCY ADVANCES However, in order to give the Bank scope and flexibility to meet special unforseeable conditions, the Mission recommends that, in addition to the rediscount powers enumerated above, the Central Bank be authorized to make advances to stockholding banks with a maturity of not more than 90 days on the security of any assets satisfactory to the Central Bank (whether or not eligible for rediscount or purchase) upon the affirmative vote of five directors.

REGULATIONS The Bank should be authorized to issue regulations concerning obligations it will accept for rediscount or as collateral for advances.

SOLVENCY OF OBLIGORS

For example, before it acquires any obligations dependent for their value in whole or in part upon the endorsement of a shareholding bank, the Central Bank might desire to have on file a recent proven statement of the adequacy and soundness of the bank's assets. The proof might consist of an audit by public accountants acceptable to the Central Bank or certification by qualified bank examiners, including if necessary, examiners employed by the Central Bank. Concerning the Cuban branches of foreign banks authoritative statements as to the condition of either the Cuban branches alone or the bank as a whole may be acceptable, provided the full credit of the entire institution stands as security for all liabilities of Cuban branches. Further, before being accepted for rediscount, all obligations bearing the names of business firms or individuals (in addition to the endorsement of a bank) should be supported by authenticated financial statements of the principal parties to such paper.

SCRUTINY OF CREDITS

The Bank should regulate its rediscounts not only by the rediscount rates charged the borrowing banks, but also by scrutiny of individual documents presented for rediscount and by direct refusals to rediscount when this

seems desirable or necessary. The right and the duty of the Bank to discriminate between desirable and undesirable loans should be clearly stated in the law.

RESPONSIBILITY FOR GENERAL CREDIT CONDITIONS

During periods of threatened undesirable credit contraction the Central Bank should not necessarily confine itself to rediscounting self-liquidating obligations of prime quality. The Bank should feel responsibility for the credit structure as a whole, for the general level of business activity and employment, and for the market for obligations of the Cuban Government and Government agencies. If measures with respect to normally rediscountable paper are inadequate, more aggressive steps should be adopted at the most effective time, with due recognition of the Bank's limitations.

LOANS TO THE GOVERNMENT

The Central Bank should be empowered to give reasonable assistance to the Central Government. Although there is an inclination in some quarters to regard any central bank accommodation to government as dangerous, it seems abundantly clear that a moderate amount of such accommodation is not only desirable under certain conditions but much less dangerous than a strict prohibition against it. The Cuban Govern-

ment should not, of course, rely upon Central Bank credit as a substitute for taxation or borrowing from the public. Caution and wisdom should be applied in determining the appropriate amount of Central Bank credit. Under ordinary circumstances and especially during unusually prosperous years, it is questionable whether the Bank should make any advances to the Government, unless short-term financing to meet seasonal fluctuations in the Government's revenues cannot be obtained at reasonable rates from other sources. However greater Central Bank assistance during periods of trade depression may be essential to the financial and economic welfare of the country. The funds should, of course, be scrupulously guarded from uses involving political favoritism or waste.

LIMITATIONS ON LOANS TO GOVERNMENT

The Mission recommends that the Bank be authorized to make loans to the Government with a maturity of one year or less, on the affirmative vote of five members of the board of directors, provided that the net total of the loans made during any one year (excluding refunding) does not exceed five percent of the Government's budgeted expenditures during the then-current fiscal year. An amount in

excess of five percent can be advanced only on the affirmative vote of six members of the board of directors.

It should be clearly understood, however, that any loans to the Government are at the discretion of the Bank, and that the Bank may reject the Government's requests for advances either for reasons of general credit policy or for other considerations of the public welfare. At the same time, the Bank should always be mindful of its special responsibilities concerning the credit of the Government.

When, as the result of such advances made over the course of two years or more, the total of such direct loans outstanding on the books of the Bank has reached an amount equal to 10 percent of the annual average budgeted expenditures during the current and next preceding fiscal years, no further advances should be made to the Government except on the affirmative vote of six directors.

Furthermore, the law should specify that in no case may an excess over the 10 percent referred to above continue to be outstanding for more than two years in any four-year period.

FINANCING OF STABILIZATION FUND

The Central Bank should help finance the Stabilization Fund's accumulations of gold or foreign exchange. This is discussed in detail in Section VII.

ASSISTANCE TO OFFICIAL CREDIT AGENCIES

Another important use of central bank credit is loans to (or investments in the securities of) official lending agencies. The American Mission is strongly of the opinion that the Cuban economy is in need of an official or semi-official agency to extend credit for agricultural purposes and that consideration should be given to the advisability of establishing agencies for industrial, public works and mortgage purposes. The Mission hopes shortly to submit a report on an agricultural lending institution. The Central Bank in turn should be authorized to give reasonable assistance to such agencies and should be directed to foster their sound development so far as is consistent with its general credit policy.

It is a distinct possibility, as well as a desirable one, that a good share of future credit expansion in Cuba will occur through such lending institutions.

More specifically, the Bank should be authorized at its discretion to acquire obligations of these agencies subject to some general protective limitations.

The limitations might take the form of a provision that the obligations must be short-term and possibly bear the guarantee of the Government and that not more than some moderate proportion, perhaps 15 percent, of the Central Bank's assets may consist of the obligations of any one of these agencies. It is not possible at this time to foresee with accuracy the maximum extent to which the Central Bank may advisably finance the agricultural and other Government credit agencies. The Mission therefore recommends that at the end of two years the Bank, with the approval of the President of the Republic, may increase the above proportion to not more than 20 percent. Any further increase in the percentage should be legislatively determined. Obligations of such agencies rediscounted with the endorsement of a shareholding bank are to be regarded as coming outside of the percentage limitation just mentioned.

EMERGENCY LOANS TO PUBLIC

With the possible exception of extreme emergencies the Central Bank should not make loans directly to the public. Private lending agencies cannot be expected to stay in business in direct competition with a central bank wich is given monopolies of note issue and holding other banks' reserves. The Bank has the further advantages of partial exemption

from taxes and services of management paid in part from other sources. Furthermore, there are important advantages to a central bank in having business loans and most bank investments made by independent, privately-managed banks. The pressure upon a semi-governmental bank to make particular loans or investments which may be undesirable can readily become intolerable.

Only, therefore, in special emergencies of credit contraction when normal banking facilities are seriously disrupted and when banks against their wish are forced to call in old loans and to refuse new ones, should the Central Bank be authorized to lend directly to the public. Such emergencies should be recognized to exist only upon proclamation by the President of the Republic (possibly with the consent of the Senate), and all loans to the public by the Central Bank might properly require an affirmative vote of five directors.

OPEN MARKET OPERATIONS

Quite apart from its direct loans and advances, the Bank should be given the powers necessary to implement its open-market policy. The Bank should have the authority to buy and sell securities in the open market at times when it wishes either to increase

or to decrease the funds available to the banking system. In this connection the Bank should be authorized to purchase direct obligations of the Republic of Cuba which have been outstanding in the open market for one year or more, short-term debentures or notes of Government credit agencies, and interest-bearing obligations of the Stabilization Fund (for which see Section VII below), whenever such purchases are required to carry out the Bank's open-market policy. Obligations of the Government issued within the preceding year may also be purchased in the open market, but all such purchases, as well as purchases of obligations of official credit agencies, should come within the respective percentage limitations recommended above. It should be required that all securities for the open-market portfolio should be purchased in the open market at prevailing prices. If the available supply of the obligations named above is too small to permit effective open-market policy, the purchase should be permitted of other seasoned, first-grade bonds which have been outstanding for two years or more.

The Bank should, of course, be empowered at its discretion to sell any assets which it is authorized to acquire.

When a market for Government securities has developed to the point where the Central Bank would be justified in undertaking limited stabilizing operations in the market for new issues of Cuban Government securities for brief periods, consideration can be given to adding to the powers of the Central Bank in this respect. The Mission recognizes that if and when an agricultural bank is established, its long-term, mortgage-secured bonds will in due time be offered in the investment market. Consideration of the relationship of the Central Bank to those securities may well be postponed until plans for the agricultural bank are more fully determined.

LOANS FOR SPECULATION

The statute might include a provision prohibiting purchase of or lending upon assets issued to finance speculation in stocks, real estate, or commodities.

NECESSARY LIMITATIONS ON CENTRAL BANK CREDIT

It may be desirable at this point to call attention to the fact that a central bank cannot be regarded as a source of unlimited financing for all desirable purposes. Loans and investments made by the central bank increase (in the absence of offsetting changes) either the currency held by the public or the legal reserves of the banks. Increases in their

reserves give the banks the means with which to expand their own loans and investments. For all commercial banks taken colectively, additional reserves permit an aggregate expansion of their loans and investments several times the amount of the increase in reserves.

CONTROL OF MEMBER BANK RESERVES

One of the basic duties of a central bank is to maintain the volume of the member banks' reserves at a level consistent with and conducive to the best interests of Cuba. The volume of reserves must not be permitted to stimulate the banks to expand their loans and investments to excess. Consequently the Central Bank must regulate the total of its own loans and investments so as not to cause a damaging over-expansion of member bank credit.

One aspect of this responsibility is that the Central Bank must not extend an excessive amount of credit to official lending agencies. Such agencies must be prepared to obtain much and at times all of their loanable fund from sources other than the Central Bank.

NEED FOR CONFIDENCE IN MORTGAGES AND SECURITIES

One of the conditions in Cuba repeatedly described to the Mission during its investigations was the impaired public confidence in mortgages and other

secured obligations. Much of this lack of confidence was attributed to the mortgage moratorium laws of recent years.

The effectiveness of a Central Bank will be considerably reduced in Cuba unless it is possible to develop willingness on the part of investors to purchase well-secured obligations of official credit agencies and of the Government. In order to help develop such confidence, it is essential that the public have faith in the fair and impartial treatment of creditors by the Government. Any opportunities utilized to demonstrate the Cuban Government's resolve to treat creditors with complete fairness should be of distinct benefit to the long-run development of Cuba's economic welfare. The Mission urges that careful and prompt consideration be given to a review of the entire mortgage moratorium situation in Cuba in order that the Central Bank and any agricultural bank which may be established may carry out their operations under reasonably favorable conditions.

IV. NOTE ISSUE AND THE RESERVE REQUIREMENTS OF THE CENTRAL BANK

RIGHT TO ISSUE LEGAL TENDER CURRENCY

The Mission recommends that the Central Bank be given the exclusive power to issue paper currency in Cuba and that the Bank's notes be given legal tender status.

TRANSFER OF SILVER CERTIFICATES

The Bank should take over the liability for outstanding issues of silver certificates and the gold and silver coin held as cover against them.

NOTES AGAINST WHICH BANK MUST HOLD RESERVES

The Mission suggests, further, that these issues should be regarded as volume of currency to which Cuba has already become adjusted. Accordingly the Bank

should be required to maintain legal reserves only against its notes which constitute a net increase in Cuba's total issues of currency outstanding at the time the Central Bank begins operations. These issues should include silver certificates and one-peso coins held by the banks and the public but not coins held as cover for silver certificates.

The replacement of silver certificates by Central Bank notes would thus not affect the reserve requirements of the Central Bank in any way. For example, if silver certificates outstanding are 100 million pesos when the Bank starts business (assuming approximately 20 million to have been issued under pending legislation), only the Bank's notes which, when added to the amount of silver certificates and one-peso coins still outstanding, are in excess of 100 million, would be subject to reserve requirements. The Bank's notes that replace the silver certificates and represent no net increase in peso currency or coin outstanding would require no reserve.

DISPOSITION OF SILVER COIN RESERVE AGAINST CERTIFICATES

The silver pesos received by the Bank need be retained only so long as silver certificates covered by the coined pesos remain outstanding. As the certificates are replaced by bank notes, either be-

cause they are worn out or because the Bank wishes to retire them, the silver coin need no longer be held as cover for silver certificates. Some asset, however, equal to the monetary value of the silver coins will be needed to keep the Bank's assets equal to its liabilities. Therefore, if at some time it should appear opportune to the Bank to dispose of its silver coin at bullion value, it would be necessary for the Bank to obtain some asset equal to the difference between the coin's monetary and bullion values. The Mission recommends that in this event the Government turn to the Bank special Government certificates with a face value equal to this difference, bearing no interest and having no maturity.

RESERVE REQUIREMENT AGAINST THE BANK'S NOTES

The reserve requirement against the Bank's notes which the Mission recommends is the moderate ratio of 25 percent. This ratio, as stated above, would apply to all note issues of the Bank in excess of the amount of Cuban currency (including one-peso coins) outstanding when the Bank begins business.

LEGAL RESERVES

The Mission recommends that the only legal reserves of the Central Bank be obligations of the Stabilization Fund secured 100 percent by gold or foreign exchange. These obligations are described in full Section VII.

PROCEDURE DURING A DEFICIENCY IN RESERVES

Whenever the legal reserves of the Bank fall below the required level, the Bank's policies should become subject to constant review by the Advisory Council. Unless authorized to the contrary by the Council, the Bank should inmediately undertake measures to restore the required reserve ratio. If the Council is not satisfied with the measures adopted by the Bank it should have the authority to require the Bank to alter its program. This authority should continue in force until the legal reserves are once again at or above the minimum requirements.

The question of whether the 25 percent reserve requirement, with a similar flexibility as regards reserve deficiencies, should apply to Central Bank deposits has produced two viewpoints within the Mission. The entire Mission is agreed that dollar deposits of the Bank should be regarded as outside the peso system and should be fully covered by dollar assets in accordance with the best practice of the commercial banks. This is discussed further in Section VI.

MAJORITY'S REASONS FOR NOMINAL CENTRAL BANK RESERVE REQUIREMENTS

Against the Bank's peso deposits, however, the mayority of the Mission recommends that no reserves be required. The principal reasons for this view are the belief that the Bank's statutory

reserve requirements should be as low as public opinion will allow and that as little prestige as possible should be given to the desirability of maintaining any fixed percentage of reserves. The Mission regards as fallacious the view sometimes held that high Central Bank reserve requirements of gold or foreign exchange are a useful means of assuring the foreign exchange stability of a currency. At times large official holdings of gold or foreign exchange may be desirable, but at all times they should be available for export. Immobilized reserves are of no direct utility in maintaining the value of a currency. Only reserves which may be exported, that is which may be used to finance payments abroad, are of value for this purpose. Reserves required to be held against the Central Bank's liabilities can be fully mobilized only by elimination of those liabilities: unless there is some such flexible arrangement as is envisaged in both the majority and minority viewpoints in this section. Such drastic credit contraction may be so damaging to the national welfare that it becomes a practical impossibility. As already stated, the Mission believes that Central Bank credit policies should be guided by more discriminating criteria than rigid reserve formulas.

The Mission is well aware that it has been customary for central banks to maintain reserves not only

against their notes but also against their deposits. In the preceding paragraph is set forth the conviction that Cuba should, so far as possible, maintain its stock of gold and foreign exchange for stabilization purposes. Even though the Bank's aggregate reserve requirements would be low on the basis of immediately prospective liabilities, the majority do not wish to require large reserves to be held when the Bank's liabilities shall have grown substantially. In order to avoid this, the majority recommends that every practicable measure be taken to prevent the banking structure of the country from being linked so closely to gold or foreign exchange as to subject that structure to shocks of a deflationary sort at time of balance of payments maladjustment. Furthermore, it is desired to avoid popular alarm due to the common misconception of the significance of Central Bank reserve requirements.

It probably must be recognized that lay opinion will not be fully content with a central banking system in which neither notes nor deposits have some sort of gold or foreign exchange reserve. For this reason the majority recommends a statutory reserve requirement of gold and foreign exchange against the notes issued by the Central Bank. As to the peso

deposits of the Central Bank, however, the majority believes that there need be no required reserves of international money.

MINORITY RECOMMENDATION OF RESERVE REQUIREMENTS AGAINST DEPOSITS

Some members of the Mission, however, believe that the Bank should be required to hold reserves against both peso notes and deposits. They consider that deposits, fully as much as notes, represent Central Bank credit, the volume of which should be limited in some measure with relation to the gold and foreign exchange resources of the country. They are further of the opinion that Cuba's gold and foreign exchange resources will be ample to provide the necessary reserves against deposits without any restriction of the legitimate credit activities of the Central Bank. On the basis of the January figures (shown in the appendix at the end of this report) 25 percent reserves against peso deposits of the Central Bank would amount to 4 million pesos. A doubling of the peso deposits in the hands of the Cuban public would raise these required reserves of the Central Bank to only 8 million pesos. Owing to the large fiduciary issue of notes for which provision is made in this report, required reserves of the Central Bank against notes are likely to be

negligible when the Bank begins business. Virtually the only reserves required would be those against deposits. Since the Cuban Stabilization Fund already had $8 million at the end of March, and there were possibly $30 million of United States currency in the hands of the Cuban public most of which should, under the new system, be replaced with pesos and acquired by the Government; and since the prospects are that the Cuban balance of international payments during the war will lead to far greater acquisitions of dollars, these members of the Mission believe that Cuba is well able to adopt what appears to them to be a more rational system of reserve requirements. In this connection they are impressed by the fact that the reserve requirements are not absolute, but allow for a smooth adjustment in the unlikely event that reserves fall below the legal minimum.

The type of reserve requirement recommended (whether against notes only or against both notes and deposits) gives some warning when the volume of Central Bank credit is out of line with the resources of the Fund, and it provides for corrective action; but it does not rigidly force the Bank into action which may be inappropriate to the economic situation at the time. If the Bank's reserves are deficient, for instance, because a bad sugar crop and an adverse balance of trade are draining the Fund's resources, the Bank may well decide that the internal

situation in Cuba requires support rather than further pressure toward contraction. In such a case, the Bank might extend credit freely as the best means of meeting the situation, pending the adoption of other measures to balance Cuba's international position. In pursuing this policy the Bank would, however, have to have the approval of the Advisory Council.

SIGNIFICANCE OF INTERNATIONAL RESERVES FOR CREDIT POLICY

The entire Mission agrees that the Bank should not expect to receive from the level of the Fund's holdings of gold or foreign exchange its principal guidance either to expand or to contract credit. Developments of recent years cast serious doubt on the wisdom of determining domestic credit policy solely on the basis of a country's holding of international reserves. Able and far-sighted central bank management should, under some conditions, encourage the expansion of bank loans even when there is only a small reserve of gold or foreign exchange and, under other conditions, a discriminating or restrictive credit policy may be desirable even though a country holds a large amount of gold or foreign exchange. It seems clearly possible that both of the hypothetical conditions just stated may sometime occur in Cuba. These problems are discussed further in Section VII.

V. RESERVE REQUIREMENTS OF COMMERCIAL BANKS

REQUIREMENTS UNDER NORMAL CONDITIONS

The Mission believes that the requirement of the Cuban Commercial Code that banks hold reserves of 25 percent of their deposits should be continued subject to possible modification by the Central Bank under special, limited circumstances. The law should require that at least four-fifths of the 25 percent be held in deposits at the Central Bank. The law should also require the same reserve against savings deposits subject to reduction at the discretion of Central Bank to a minimum of 5 percent. Coincident with this power to reduce the requirements, the Bank should have the power to define such

deposits and issue regulations concerning them. The currency in which these reserves must be held is discussed in the next section.

EMERGENCY CONTROL OF RESERVE REQUIREMENTS

In case of threatened over-extension of bank loans or investments, the Bank should have the power to require that commercial banks hold peso reserves higher than those regularly required.

In the interest of Cuban welfare as well as in justice to the banks, limitations should be written into the law designed to protect the banks against injury from application of this power. The higher reserve requirement ratio should apply only to demand deposits in excess of those held by each bank at the time the increase is ordered. Furthermore, it should be required that the Central Bank make what provisions are necessary to allow banks to take care of any firm commitments to lend entered into before the increase is announced. It should also be clearly understood that banks will be permitted to levy charges on bank depositors sufficient to cover the costs of maintaining checking services, including among the costs a fair profit on the banks' capital in Cuba. These costs are ordinarily covered by the income from the banks' earning assets, but if they

are not permitted to increase their earning assets as their deposits increase, the banks should be compensated through service charges. The Central Bank should also be authorized to make adjustments for new banks in order to permit them some degree of expansion of credit.

The Bank should have the power to cancel any increase in reserve requirements above 25 percent. In periods of emergency the Bank should also have the power to reduce reserve requirements below 25 percent.

VI. THE STATUS OF THE DOLLAR IN CUBA

PESO SYSTEM DESIRABLE

Special problems are raised by the existence in Cuba of a large volume of bank deposits, bank loans, securities, and currency, all denominated in United States dollars, side by side with similar instruments denominated in pesos. An exact statement of the degree to which this dual monetary system is disadvantageous to Cuba will not be undertaken in this report. Nevertheless, the disadvantages seem clearly to preponderate.

METHOD OF TRANSITION

The Mission believes that Cuba should progress from a dual peso-dollar system to an all-peso system by gradual, voluntary stages. Legislation to enforce an abrupt,

compulsory conversion seems likely to do more harm than good. The transition should be brought about by increasing the prestige of the peso through careful and wise monetary policies.

LEGAL TENDER POWER OF THE DOLLAR

The Mission recommends that the legal tender power of United States dollars be terminated at once. But it doubts that other impediments against their use or measures forcing dollars out of Cuba would be in Cuba's interest at this time. Obligations denominated in dollars should be payable in dollars with full legal sanction. The Stabilization Fund and the Central Bank should then devote themselves to the task of winning full public confidence that pesos are more desirable than dollars for people in Cuba to hold an use.

At some future time, consideration should be given to the use of dollars, possibly including taxation at a very low rate on all transfers from pesos into dollars, extra charges or taxes upon the keeping of dollar bank balances, and other measures.

LAW OF JULY 8, 1939

Ending the legal tender power of dollar will probably render obsolete the provisions of the law of July 8, 1939, whereby banks are required to meet dollar liabilities in dollars

but certain classes of bank borrowers (as well as other debtors) may repay dollar loans with a like number of pesos, regardless of the current exchange rate. Even though this provision of the law should have become ineffective, the Mission believes that it would be advisable that this provision of the law be specifically repealed. Obligations should be payable only in the currency in which they are denominated. With the peso at parity with the dollar, repeal of this law will cause no burden upon anyone.

The provision of this law which apparently results in penalizing any person quoting a foreign exchange rate for the peso lower than the previous quotation should also be repealed. It is now generally recognized that it is based upon a misconception of how an untrammeled foreign exchange market should work and prohibits banks, which are foreign exchange brokers, from responding to the forces of supply and demand in both directions. The repeal of this law would be more a matter of principle than of important effect, since the Stabilization Fund should succeed in eliminating all but trifling fluctuations in the rate of exchange.

DOLLAR POSITION OF BANKS

So long as dollar bank balances exist in Cuba, banks should be required by law to keep their dollar assets and their

peso assets in substantial balance with their respective dollar and peso liabilities. Such legislation will only make compulsory what is understood already to be the firm practice of the banks now in Cuba.

BANK RESERVES AGAINST DOLLAR DEPOSITS

The Mission recommends further that banks be permitted to hold their legal reserves against dollar deposits in dollars for a period of five years. Peso reserves would have to be held against peso deposits. After five years, banks should be required to hold all their legal reserves in pesos. This provision will give ample warning of the change and should end uncertainty concerning the proportion of dollars and pesos required to be held as commercial bank reserves. It will also give the commercial banks ample opportunity to induce their customers to hold deposits in pesos rather than in dollars.

Against all its deposit liabilities denominated in dollars (including the member bank's reserve deposits referred to just above), the Central Bank should be required to keep a 100 percent cover of high-grade, liquid dollar assets.

VII. THE STABILIZATION FUND AND ITS RELATION TO THE CENTRAL BANK

GENERAL POWERS OF STABILIZATION FUND

The Mission recommends that the Cuban Stabilization Fund be empowered to acquire gold and foreign exchange and to use those holdings to stabilize the foreign exchange value of the peso during periods when the balance of payments is adverse. In order to build up such holdings, the Fund should have at its disposal adequate peso financing, so that it can retain gold or foreign exchange until needed.

FUND'S PREVIOUS LACK OF PESO FINANCING

The Fund as now constituted has usually had to sell its acquisitions of dollars within a very short time. The Fund's principal source of foreign exchange

has been the dollars which sugar and molasses exporters were required to deliver to the Fund at par. They were entitled to receive prompt payment of a like number of pesos. While the Fund had access to general Treasury funds, the Treasury has usually needed all its funds within brief intervals to meet budgetary expenditures. Some of the Fund's dollars were purchased by the Treasury at par to meet the Government's expenditures abroad. The Fund was obliged to sell most of its remaining dollars in the foreign exchange market in order to obtain pesos with which to reimburse the exporters delivering dollars. The Fund could retain only whatever premium there was on the dollar. When the dollar was at par or at a small discount, as in the first quarter of 1942, there was no profit in such operations and there may have been a loss.

WEAKNESS IN BALANCE OF INTER-CURRENCY PAYMENTS

Lack of adequate peso financing has not been the only factor preventing the Fund from building up a stock of gold or foreign exchange in the period prior to the last quarter of 1941. While the peso was at a discount, any attempt by the Fund to accumulate foreign exchange would have tended to depress it further.

CURRENT STRENGTH

In recent months, however, the peso has gone to a premium. Were the dollar not used directly as money in Cuba, the Fund would currently be engaged in acquiring dollars in exchange for pesos on substantial scale. The Mission is recommending a peso system for Cuba with Fund operations on whatever scale is needed to maintain parity between the peso and the dollar.

POSSIBLE LOCATION OF THE FUND

A good case exists either for placing a country's foreign exchange stabilization operations in the central bank or for establishing an independent fund. The difference between the two methods is perhaps more apparent than real.

If the central bank buys the gold or foreign exchange, each peso's worth that is acquired will ordinarily be financed by an increase of one peso in the central bank's outstanding banknote or deposit liabilities. If the stabilization fund is independent or is a part of the Treasury, the acquisition of monetary gold or foreign exchange may be financed by issuing against the gold and foreign exchange acquired some obligation such as gold or foreign exchance certi-

ficates. These could be designed to serve either as circulating currency or as the means of obtaining a deposit in the central bank.

If, however, the monetary authorities desire to finance the increase in the stock of gold or dollars without issuing new money, it is possible to do so, whether the fund is part of the bank or separate from it, by means which are discussed below.

REASONS FOR INDEPENDENT FUND

The Mission feels that there is a preponderance of advantage at the present time in making the Cuban Stabilization Fund separate from the Central Bank, for the following reasons: (1) Responsibility for the foreign exchange value of the peso and operations to stabilize that value should be placed in an agency fully responsible to the Government. (2) Profits or losses arising from stabilization operations should be for the account of the Government and this accounting can be carried on more conveniently and understandably when the Fund is separate than when it is part of the Bank. (3) A separate Fund makes it easier to handle the financing of acquisitions of gold and foreign exchange by borrowing from the public. The significance of this measure is discussed further on in this section.

MANAGEMENT OF THE FUND

The management of the existing Stabilization Fund in Cuba is wholly within the Treasury. With the establishment of a Central Bank it appears advisable to the Mission that the Governor of the Bank should participate in the management of the Fund just as the Minister of Finance participates in the management of the Bank. The community of interest and problems is so close that this mingling of the managements should contribute to efficiency and unified policy. The Mission therefore recommends that the Stabilization Fund be administered by a committee composed of three members: the Minister of Finance, who should be chairman, an appointee of the Minister of Finance, and the Governor of the Central Bank.

OVERDRAFT METHOD OF FURNISHING PESOS

Probably the simplest method for financing the peso requirements of an independent Fund is to give it the right to incur a peso overdraft at the Central Bank up to the cost of any gold or foreign exchange added to the Fund's holdings. When the Fund buys gold or foreign exchange —either in the open market or from exporters delivering dollars as the law now requires— the Fund can pay for it with a check drawn on the Central Bank, in pesos. The check

being acceptable at any bank, the seller of the gold or foreign exchange will receive payment at his convenience. When the check is presented to the Central Bank in turn by a commercial bank, both the Central Bank's liabilities (either notes or deposits due to banks) and the Bank's assets —i.e., the overdraft of the Stabilization Fund— will increase by equal amounts.

TERMS OF THE OVERDRAFT

Unless considerations of Central Bank credit policy dictate otherwise, the overdraft need not be repaid until the Fund wishes to use the gold or foreign exchange securing it. At that time the Fund will support the peso in the foreign exchange market by selling gold or foreign exchange in exchange for pesos. The pesos so obtained will be applied on the Fund's overdraft at the Bank.

The Mission recommends that when this Central Bank overdraft method is used to finance accumulation of gold and foreign exchange, the overdrafts bear no interest and have no maturiy. This will give the Fund the approximate equivalent, so far as ability to obtain pesos is concerned, of the United States procedure of financing acquisitions of gold by issuing gold certificates to the Federal Reserve Banks.

The Fund should retain title to any gold or foreign exchange which it acquires, but the gold or foreign exchange could be held by the Central Bank as trustee.

EFFECT ON COMMERCIAL BANK RESERVES

As already stated, use of Central Bank overdrafts to pay for accumulations of gold and foreign exchange will increase, peso for peso, the currency or bank deposits held by the public, provided that offsetting changes do not take place. The public's monetary habits will automatically determine whether the increase occurs in currency or in deposits. To the extent that it occurs in deposits, the overdraft method will result also in increasing the reserves of the commercial banks by a like amount. These in turn will be the legal basis for a multiple expansion of commercial bank credit, as discussed in Section III. Under some circumstances, increases of member bank reserves freely available for the expansion of bank loans and investments may be regarded as undesirable.

During the war, when Cuba's balance of international payments may result in very large net payments to Cuba, the financing of the Fund may be a major influence in the domestic credit situation.

The Central Bank should be given power to regulate this financing insofar as possible so as not to cause undesirable effects on domestic credit conditions. If it should be made compulsory that the Bank finance the Fund without interest and without limit, the Bank would probably be unable to pursue a policy of moderating credit expansion in the years immediately ahead without at least resorting to strong emergency measures of control.

The Bank will not have ordinary loans, or assets suitable for sale in the open market, in nearly sufficient volume to absorb the member bank reserves created in financing the Fund. Cuba's favorable trade balance during the coming year will probably exceed $100 million. Part of this balance may be left abroad or placed in dollar deposits in Cuba, but in addition to the trade balance there will be several other sources of dollars which may be offered to the Fund. More than $30 million were estimated to be in public circulation in Cuba at the end of March, and this may be offered in large part to the Fund. To the extent that proceeds of the $25 million credit from the Export-Import Bank and the $20 million Reconstruction Finance Corporation advance for the development of Cuban nickel deposits are spent in Cuba rather than for imports from the United

States, they will have to be converted into pesos. It would be unsafe not to reckon with a possible acquisition of at least $50 million —perhaps several times that figure— by the Fund in the next year or two. The appendix to this report shows what might be the effect on the domestic credit situation of an acquisition of $50 million by the Stabilization Fund.

TWO SPECIAL POWERS TO CONTROL BANK CREDIT

To deal with such a situation, the Mission recommends that the Bank be given two special powers: first the power to raise the legal reserve requirements of commercial banks, as stated in Section V, and second, the power to compel the Fund to obtain its pesos outside the Central Bank. Other measures which may be necessary to prevent inflation in Cuba lie outside the usual functions of a Central Bank, though of course the Bank may give advice to the Government on their adoption.

RESULTS OF THE POWER TO RAISE RESERVE REQUIREMENTS

By use of the power to raise reserve requirements the Central Bank could limit the further expansion of bank loans and investments to any degree desired, although frequent changes in reserve requirements would be inadvisable. The qualifying provisions recommended in Section V would make unnecessary

any forced contraction of loans and investments already made. Each bank could continue to maintain its previous volume of loans and investments outstanding, with such further growth as the Central Bank and the conditions permitted. Furthermore, banks could continue to receive their previous income from loans and investments, possible augmented by some increase in interest rates and income from service charges sufficient to compensate for the cost of deposits against which high reserves are required.

FINANCING THE STABILIZATION FUND OUTSIDE THE CENTRAL BANK

The second special control which the Mission recommends is that the Central Bank be given the power to require the Fund to cease drawing upon it, or even to reduce its overdraft to any extent and at any time the Central Bank deems it advisable. Exercise of this power by the Bank should require an affirmative vote of five directors. The effectiveness of this power as a credit-control device is readily apparent: Buying gold or foreign exchange with pesos obtained from sources other than the Central Bank tends to prevent the growth of legal bank reserves.

THE OTHER SOURCES AVAILABLE

To the extent that the Fund had to finance its acquisitions outside the Central Bank it could draw upon the general revenues of the Treasury, or it could sell a new type

of credit instrument to the market. The Mission suggests that this new instrument might be a short-term note of the Government secured by the gold and dollars of the Fund. The Mission has been informed that a note so secured would have exceptional credit standing in the Cuban market and under ordinary circumstances would sell readily at a very low rate of interest. Of course, if a firm money policy were being put into effect by the Central Bank, the rate of interest on these notes would reflect the general high level of interst rates, although it should still have a considerable differential in its favor.

The extent to which the gold and dollars acquired by the Fund should be prevented from having the effect of increasing the reserves of the commercial banks should be left for determination in the light of circumstances current at the time.

INTEREST ON FUND BORROWING

In all probability interest paid on these Fund notes to make them acceptable to lenders will ultimately have to be paid by the Government out of its general funds. The interest payments will probably exceed any profits which the Fund can make by stabilization operations around par of exchange. On the other

hand, Stabilization Fund notes fully secured by gold or dollars should be saleable at considerably lower interest cost than other obligations of the Cuban Government or of official credit agencies such as an agricultural bank. At any time when, for reasons of credit policy, only a limited amount of Central Bank credit can be made available to the Central Government, official credit agencies, and the Fund, combined, it may be a net saving to the Government as a whole if the Fund is financed partly in the open market, leaving the available Central Bank credit for the Government or the lending agencies. Thereby obligations bearing the lowest rates of interest would be sold to the open market while obligations bearing higher rates of interest would be bought by the Central Bank. Since the Government is the residual beneficiary of Central Bank earnings, this procedure would reduce the Government's net cost of borrowing.

THE PROBLEM OF INADEQUATE INTERNATIONAL RESERVES

A threatened excess of gold or foreign exchange in Cuba should probably be regarded as abnormal. In setting up the Central Bank attention must also be paid to the opposite possibility, that of the exchange stabilization authorities having difficulty in meeting an adverse balance of international payments.

CREDIT POLICY IN RELATION TO INTERNATIONAL RESERVES

The Mission fully recognizes the importance of protecting the exchange stabilizing operations of the Stabilization Fund from excessive credit expansion permitted by the Central Bank. The Fund is responsible for maintaining the foreign exchange value of the pesos issued by the Bank. Conceivably the Bank might render the Fund's task impossible if it allowed an expansion of credit without relation to the gold and foreign exchange resources of the Fund. Cuba's economy is markedly dependent on export markets for sale of its production and on imports for supplies of many types of goods. Accordingly the Bank's decision to stimulate domestic purchasing power must be guided by the danger of engendering a demand for imports larger than current exports can pay for, after meeting other necessary foreign payments. The Mission therefore recommends that Central Bank credit policies be determined with constant reference to the resources of the Fund and to the problem of maintaining the foreign exchange stability of the peso. The presence on the Bank's board of directors of two of the three members of the Fund's management should serve in large part to integrate their respective policies.

EMERGENCY EXCHANGE LICENSING

To provide for the possibility that Cuba may some day be faced with a net balance of foreign payments so adverse as to exhaust or (threaten to exhaust) the official holdings of gold and foreign exchange, the Mission recommends that the framework be set up within which it will be possible to subject all foreign exchange transactions to license. Such a step may be a necessary preliminary to a basic adjustment of the exchange rate or other measures designed to permit reopening of a free exchange market on a secure basis. Or it might prove desirable under the circumstances of the time to continue the moderating influence exerted by a licensing system upon such foreign payments as excessive imports, speculation against the peso, heavy purchases of foreign securities, flight of capital, etc. The President should be authorized, on the advice of the Stabilization Fund Committee, to require licensing of foreign exchange transactions by the Minister of Finance. Whether or not this power is ever utilized is left to the judgment of the Cuban monetary authorities in power when the need may arise. It is an emergency power which should be used only when the Fund's capacity to stabilize exchange threatens to be inadequate.

DOUBTFUL USEFULNESS OF EXCHANGE DEPRECIATION IN CUBA'S BALANCE OF PAYMENTS CONTROL

Although not wishing to restrict the judgment of those authorities acting in the light of actual future conditions, the Mission, as suggested in the previous paragraph, holds the view that for Cuba some measure of foreign exchange rationing is preferable to efforts to restore balance of payments equilibrium by wide or frequent fluctuations in the foreign exchange rate. In support of this view it may be argued, first, that Cuban exports will not be increased substantially by depreciation of the peso; second, that the value of Cuban imports will not be reduced to a sufficient degree or in a desirable manner by a depreciating peso; and third, that transfers of funds abroad may be so aggravated by depreciation or the fear of further depreciation that it will do considerably more harm than good. These suggestions, however, apply only to conditions which can now be foreseen.

The Mission, fully recognizes the possibility that future events may cause the peso to become overvalued or undervalued in relation to other currencies. At such a time the foreign exchange authorities may conclude that this overvaluation or undervaluation reflects enduring maladjustment in Cuban costs and prices in relation to those abroad. In this event, it

would be appropriate to recommend to the Cuban Congress a change in the price of gold and hence in the par of exchange.

Under present and prospective conditions, however, the Mission believes that the statutory gold value of the peso should be set at parity with the United States gold dollar and that the Cuban Stabilization Fund should maintain the foreign exchange value of the peso within a range of minor, technical fluctuations around parity, i.e., within a range of not more than two percent in either direction. Central Bank credit policy should be determined in full consideration of Cuba's exchange outlook, but, when appropriate domestic credit policy and other measures are unable to keep the balance of foreign payments in equilibrium, the Government should, in the opinion of the Mission, expect to achieve a more satisfactory adjustment by directly restraining certain types of international transactions or by a basic revaluation of the peso than by a policy of exchange depreciation.

SUMMARY OF RECOMMENDATIONS OF SECTION VII

Specifically, and in recapitulation, the Mission makes the following recommendations concerning the establishment and functioning of a Cuban

Stabilization Fund and concerning the disposition of Cuba's gold and foreign exchange reserves:

(1) Cuba's stocks of monetary gold and foreign exchange should be segregated in a Stabilization Fund to be used for the stabilization of the peso. The Fund should be charged with the responsibility of purchasing, holding, and selling gold and foreign exchange to stabilize the peso. The Fund should stabilize the foreign exchange value of the peso at the equivalent of the gold value of the peso, allowing only minor, technical fluctuations around that level.

(2) Management of the Fund should rest with a committee of three, consisting of the Minister of Finance, the Governor of the Central Bank, both ex officio, and one member selected by the Minister of Finance.

(3) The Fund should be authorized to obtain pesos from the Central Bank with which to purchase gold or foreign exchange on the basis of overdraft facilities bearing no interest and having no maturity but fully secured by gold or foreign exchange. In addition to incurring overdrafts at the Central Bank, the Fund should be authorized to borrow from the public (including the commercial banks) on interest-bearing notes secured by gold and foreign exchange.

The Fund should be authorized to pledge its holdings of gold and foreign exchange to secure these notes. The Central Bank should have the power to require the Stabilization Fund to cease expanding its overdraft at the Bank or to reduce it to any extent the Bank deems advisable.

(4) Profits and losses from the operation of the Fund should be for the account of the Treasury.

(5) The Fund should be required to publish audited reports showing the disposition of profits and any disposition of foreign exchange or gold made at prices other than the prevailing market price at reasonable intervals after the transactions take place.

(6) The President of the Republic should have power to order, on the recommendations of the Fund Committee, that any or all foreign exchange transactions, imports, exports, and international movements of funds be subject to license by the Minister of Finance.

(7) The Fund should be authorized to hold pesos against its overdrafts at the Central Bank, in any form acceptable to the Bank.

The purpose of this provision is to make it possible, when desirable, not to reveal the time and the mag-

nitude of the operations of the Stabilization Fund. Operations may be conducted in confidence much more successfully if, at a time when the Fund is selling its gold or dollars in order to support the peso, it can maintain its overdraft at the Central Bank rather than reduce it as soon as gold or dollars are sold. Otherwise, the Fund's operations and the size of its holdings of gold and foreign exchange could readily be detected through an inspection of the changes in the size of the Fund's overdraft in the balance sheet of the Central Bank. The overdraft may be maintained unchanged if the Fund is permitted to secure its overdraft either with gold and foreign exchange or with pesos. As gold and foreign exchange are withdrawn, pesos obtained from their sale could be substituted. The security for the overdraft would still be complete. To preserve its control over bank reserves, the Bank should be given authority over the form in which the Fund may keep its peso holdings, as between currency, deposits in the Central Bank, or deposits elsewhere.

(8) The Fund should be permitted to invest in high-grade foreign securities any of its gold or foreign exchange not pledged as security for its liabilities with due regard to the need to have a considerable portion of its foreign exchange resources sufficiently liquid for immediate use.

VIII. MISCELLANEOUS PROVISIONS

DEPOSITS The Bank should be authorized to hold deposits only of commercial banks, the Government, governmental institutions, and foreign governments and central banks. Deposits may be accepted in any currency at the discretion of the Bank.

SYMBOL FOR PESO The law might provide for the adoption of some symbol for the peso in order to facilitate its differentiation from the dollar.

EXAMINATIONS AND AUDITS The Bank should have the power to require examinations and statements of condition of banks in Cuba audited by public accountants acceptable to the Bank, and to authorize or prohibit the opening of new banks and branches.

RESEARCH The Bank should be authorized to conduct research, to publish bulletin and reports, and to obtain information necessary for the conduct and formation of its policies.

FISCAL AGENT The Central Bank should be the fiscal agent of the Treasury of the Republic, and as such should perform such services as are typically required of fiscal agents by the Minister of Finance. Expenses due directly to the carrying out of such services should be reimbursed to the Bank by the Treasury.

TAX PRIVILEGES The Central Bank should be free of certain taxes (to be specified by Cuban tax specialists). It possibly should have the mail franking privilege, though this is not essential.

BRANCHES The Bank probably should have the power to establish branches and angencies.

SUMMARY OF PRINCIPAL RECOMMENDATIONS

I. *Capital.*

5 million pesos in cash of which about 3 million to be subscribed by member banks and about 2 million by the Government.

3 million pesos of capital surplus, to be contributed by the Government in the form of special Treasury obligations.

Dividends on member-bank shares to be limited to 4 percent; the Government to receive no dividends, but to receive all earnings after provision for earned surplus, which accumulates on behalf of the Government.

II. *Management.*

A Board of Directors of seven members to control the Bank.

The members will include:

The Governor of the Bank, selected by the President.

The Finance Minister, *ex officio.*

The head of the Agricultural Bank or an additional Class B director.

Two Class A directors appointed by the President from panels nominated by the member banks.

Two Class B directors appointed by the President.

An Advisory Council on Monetary Policy, composed of Cabinet officers and Presidential appointees, to consult and advise with the Government and the Bank on major matters of credit policy.

III. *Loans and Investments.*

The Bank shall have the power to:

Rediscount for member banks 120 day commercial and 180 day agricultural paper or make 90 day advances secured by such paper.

Make direct emergency 90 day loans to member banks on any sound assets.

Extend loans to the Government, subject to specified limitations.

Extend loans to official credit agencies, subject to specified limitations.

Help finance the Stabilization Fund's accumulation of gold or foreign exchange.

Make direct loans to the public under specified emergency conditions.

Carry out open-market purchases and sales to implement credit policy.

IV. *Note issue and the reserve requirements of the Central Bank.*

The Bank to have the exclusive note issue power.

The Bank to assume the silver certificate liability and the silver peso reserves.

The Bank to maintain a reserve against its notes (and possibly its peso deposits) of 25 percent in the gold - or dollar - secured overdrafts of the Stabilization Fund, subject to emergency relaxation. This

reserve requirement not to apply against notes issued by the Bank to replace silver certificates.

The Bank to hold full dollar cover against dollar deposits.

V. *Reserve requirements of commercial banks.*

The commercial banks to hold reserves of 25 percent of their deposits (in the currency of the deposit), of which four-fifths is to be maintained as a balance in the Central Bank.

The Bank to have power to vary reserve requirements of member banks as a means of credit control, with limitations on this power designed to protect the interest of the banks.

VI. *Status of the dollar in Cuba.*

The legal tender power of the dollar to be terminated at once, but banks to be required to hold dollar assets substantially equal to their dollar liabilities.

At the end of five years all legal reserves to be held in pesos.

VII. *The Stabilization Fund and its relation to the Central Bank.*

The stocks of monetary gold and foreign exchange to be segregated in a Stabilization Fund, to be administered, for the account of the Government, by the Finance Minister, the Governor of the Bank, and an appointee of the Finance Minister.

The Fund to finance its operations by interests-free overdraft at the Central Bank unless the Bank, for reasons of credit policy, withdraws this privilege, in which case the Fund is to turn to the Treasury or the money market for accommodation.

The Fund to stabilize the foreign exchange value of the peso at the equivalent of the gold value of the peso, permitting only minor technical fluctuations.

Power to change the price of gold (and hence parity of the peso) to rest with Congress.

APPENDIX

TENTATIVE BALANCE SHEETS OF THE PROPOSED CENTRAL BANK

CASE I.—The balance sheet of the Central Bank, set up in accordance with the terms of this report and on the basis of the Cuban currency and deposit figures of January 31, 1942, would look semewhat as follows:

(In millions of pesos or dollars: $)

ASSETS		LIABILITIES	
a. Silver coin	78	g. Silver certificates	79
b. Silver certificates	16	h. Bank's own notes	0
c. Fund overdraft	2	i. Government deposit	1
d. Securities without interest	3	j. Com. banks: 20% of peso deposits	13
e. Earning assets	2	k. Capital: Banks	3
Total peso assets	101	l. Government	2
f. Dollar currency	$ 14	m. Capital Surplus	3
Total assets	115	Total peso liabilities	101
		n. Com. banks: 20% of dollar deposits	$ 14
		Total liabilities	115
RELATED ITEMS		**RELATED ITEMS**	
Peso notes outside banks	58	Required reserves of Central Bank:	
Peso cash in commercial banks:		25% of its notes	0
o. Legal minimum (5% of peso deposits)	3	25% of its peso deposits (if required)	4
p. Excess reserves	7	100% of its dollar deposits	$ 14
Commercial bank deposits:			
Peso	67		
Dollar	$ 72		
TOTAL	139		

Each of the items in the balance sheet above may be briefly explained. When the Bank assumes the liability for the 79 million pesos of silver certificates outstanding on January 31, 1942 (item g), it will receive the 78 million pesos of silver coin held against them (item a.) and the 1 million pesos of gold so held. It is assumed that the Fund, which will hold the official gold and foreign exchange of Cuba, buys this 1 million pesos of gold by a corresponding overdraft on the Bank (item c.). The overdraft is increased to 2 million pesos when the Fund buys the $1 million dollar currency which the Government held on January 31, 1942, and which is assumed to be deposited with the Central Bank (item i.). The 2 million of peso currency that the Government held on January 31, 1942, is assumed to be paid in as the Government's subscription to the capital stock of the Bank (item l.), an operation which contributes 2 million pesos to the Bank's holdings of silver certificates (item b.). The remaining 14 million pesos of silver certificates in this item are deposited by the commercial banks. These banks had 24 million pesos of silver certificates and coin in their vaults on January 31, 1942. Under the plan proposed they could count only 3 million pesos of this (5% of their peso deposits: item o.) toward meeting their legal

requirements. They might wish to hold another 7 million pesos (10% of their peso deposits: item p.) in excess of the legal minimum as working reserves. This would leave them only 14 million pesos of silver certificates to pay in to the Central Bank as a subscription to capital (item k: 3 million pesos) and toward providing the reserve balance (item j: 13 million pesos) which the law will require them to keep with the Central Bank. The 14 million pesos of silver certificates are thus 2 million pesos short of the 16 million required for capital and reserve balances. This 2 million pesos the commercial banks may borrow directly from the Central Bank or the Central Bank may put the funds out through loans to the Government or to the Agricultural Bank (if it is in existence) or possibly through open-market operations. Whatever the method, earning assets of the Bank (item e.) will amount to 2 million pesos. The 3 million peso surplus of the Bank (item m.) is contributed by the Government in the form of securities without interest (item d.). This accounts for all the peso items. The dollar items reflect the fact that the commercial banks are required to pay in 20% of their dollar deposits (item n.) in the form of dollar currency (item f.). Should the Central Bank in order to obtain earnings invest this currency

in dollar securities abroad, which it has the right to do, item f. would change its title accordingly; but the transaction would be without effect on the peso balance sheet and would add nothing to the Bank's power to influence the volume of peso credit through open-market operations.

CASE II.—The main report has called attention to the wide range of possibilities in Cuba's balance of international payments during the war. The surplus on merchandise trade may be more than $100,000,000 a year. Some of this will be used in payment of dividends abroad and for other purposes and much of what is not used up may be left in the form of dollars instead of being converted into pesos. The outcome is unpredictable, but it would be reasonable to suppose that the Stabilization Fund will be called upon to buy at least $50,000,000 in the next year or two. If exporters and others generally convert their accruing dollars into pesos, Fund acquisitions may be several times this figure.

Should $50,000,000 be acquired by the Fund by means of an overdraft on the Central Bank, and should the resulting 50 million pesos go half into circulation and half into commercial bank deposits,

the Central Bank's balance sheet and related items presented in Case I would be altered as shown below:

(In millions of pesos or dollars: $)

ASSETS		LIABILITIES	
Silver coin	78	Silver certificates	79
Silver certificates	0	Bank's own notes	29*
Fund overdraft	52	Government deposit	1
Securities without interest	3	Com. banks: 20% of peso deposits	18*
Earning assets	2	Capital: Banks	3
Total dollar assets	135	Government	2
Dollar currency	$14	Capital Surplus	2
Total assets	149	Total peso liabilities	135
		Com. banks: 20% of dollar deposits	$14
		Total liabilities	149
RELATED ITEMS		**RELATED ITEMS**	
Peso notes outside banks	83	Required reserves of Central Bank:	
Peso cash in commercial banks:		25% of its notes	7*
Legal minimum (5% of peso deposits)	5	25% of its peso deposits (if required)	5*
Excess reserves	25*	100% of its dollar deposits	$ 14
Commercial bank deposits:			
Peso	92		
Dollar	$ 72		
TOTAL	164		

* To the extent that excess reserves are kept in the form of balances at the Central Bank, the Bank's issue of its own notes will be reduced, and its required reserves will be altered accordingly.

Meanwhile dollar deposits of the commercial banks could grow rapidly without affecting the peso earning assets of the Central Bank. Their only effect on the peso balance sheet would be to increase capital subscriptions, which the banks are required to make

at the rate of 2 percent of their total deposits, and to cut down correspondingly the Central Bank's note issues. The reduction in note issues would occur because the commercial banks would use their idle excess reserves (in the form of currency in their vaults) to make the capital subscription. There has been a primary expansion of 50 million pesos in the Cuban public's means of peso payment.

Several comments may be made on this second balance sheet. Money in circulation outside the commercial banks has risen 43 percent as compared with Case I. Peso deposits have risen 37 percent and dollar deposits, although not shown as increasing in the table, could in fact increase by much greater percentages without material effect upon peso earning assets of the Bank. These peso loans or earning assets remain at the low figure of 2 million pesos (i.e., no additional loans have been made to the commercial banks, the Government, or the proposed agricultural bank). Should the Bank allow its loans to run off completely and should it convert its 3 million pesos of Government securities without interest into 90 day bills and sell them to the market, as it has the right to do, it would diminish the peso reserves of the commercial banks by only 5 million. The com-

mercial banks hold 48 million pesos of reserves — 25 million pesos more than the 23 million (25 percent of 92 million of peso deposits) which the law requires them to keep either with the Central Bank or in their own vaults. This 25 million pesos of excess reserves would be reduced to 20 million if the Central Bank eliminated its earning assets and sold all its securities without interest; but the 20 million, amounting to 22 percent of the expanded volume of peso deposits, would still be far greater than any reasonable working needs of the commercial banks, which in Case I were assumed to be 10 percent of peso deposits—a generous figure.

On the basis of these excess reserves the commercial banks could expand their loans and deposits still further in an active business situation, the exact amount depending upon how much the public added to their pocket money instead of increasing their deposits at the banks. It is clear that if the Central Bank wished to prevent this secondary expansion of currency and deposits in Cuba, the only instrument it could employ would be that of requiring the Fund to reduce its overdraft. To the extent that the Fund use Treasury revenues for this purpose or borrowed from the commercial banks (or from the depositors at these banks) excess reserves of the com-

mercial banks would be drawn upon to pay off the Fund's overdraft at the Central Bank and hence would disappear.

While it is true that the only instrument the Central Bank could use to eliminate secondary expansion on the basis of excess reserves once they had accumulated (as in Case II) is that of requiring the Fund to repay a portion of its overdraft, the excess reserves might have been prevented from appearing at all had the commercial banks been required to hold 100 percent reserves from the very first against any expansion of deposits. Even this extreme use of the power to raise reserve requirements, however, would not prevent a primary 50 million peso increase in Cuban currency and deposits resulting from a Fund purchase of 50 million dollars through overdraft at the Central Bank. It is also unlikely that a primary expansion of this sort could be wholly prevented by financing the Fund outside the Central Bank, but the expansion would be curtailed to the extent that (1) the Fund employed Treasury resources, (2) Fund notes were sold to others than the commercial banks, or (3) Fund notes, sold to the commercial banks, replaced maturing loans without expanding the total loan portfolio of these banks. It would hardly be possible to finance the Fund on such a scale by these three

methods alone, and hence some primary expansion of commercial bank credit on reserves supplied by the Central Bank would appear to be inevitable. In Case II the full primary expansion of 50 million pesos has been assumed.

One further point may be noted in connection with the excess reserves of the commercial banks in Case II. It is assumed that they are all kept in the form of additional currency in the banks' own vaults. They could almost as well be kept in the form of an additional balance at the Central Bank. Were the whole 25 million pesos thus transferred, the note issue of the Central Bank would drop from 29 million pesos to 4 million and commercial bank deposits at the Central Bank would rise from 18 million pesos to 43 million. The transfer would be without effect upon the assets of the Central Bank but, if the Central Bank were required to keep 25 percent reserves against its note issue alone, its required reserves would be reduced by the discretionary action of the commercial banks from 7 million pesos to 1 million. If, however, the Central Bank were required to hold 25 percent reserves against both its note issue and its peso deposits, its required reserves would be the

same whether the commercial banks decided to hold their own reserves as a balance with the Central Bank or as currency in their vaults.

Throughout Case II the assumption has been made that the Fund purchases 50 million dollars by overdraft on the Central Bank, and the effects of this operation on the credit situation have been traced. The discussion in the main report suggests the possibility that before the war is over the Fund may have to purchase a much larger amount of dollars than this. It is evident that the greater the scale of the Fund's operations, the greater the effects on the domestic credit situation will be.

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American Technical Mission to Cuba

COMMENTS ON THE DRAFT MONETARY LAW

Third Report to the Cuban Government

June 18, 1942

Personnel of Mission

G. A. Eddy, Treasury Department
A. T. Esgate, Farm Credit Administration
W. R. Gardner, Board of Governors of the Federal Reserve System
F. A. Southard, Jr., Treasury Department
H. R. Spiegel, Treasury Department
G. B. Vest, Board of Governors of the Federal Reserve System
H. D. White, Chief of Mission, Treasury Department

AMERICAN TECHNICAL MISSION TO CUBA

June 18, 1942

Dear Mr. Minister:

You will recall that on the occasion of your recent visit to Washington you handed to the Mission copies of three draft laws, one of which was a Monetary Law.

Members of the Mission have given careful consideration to the draft Monetary Law from two points of view:

1. In the light of the Mission's recent Second Report to the Cuban Government, dealing with the Central Bank and the Exchange Stabilization Fund, are there any changes which should be made in this draft law?

2. What additional suggestions or comments might the Mission appropriately make on the provisions in the draft law?

I herewith submit to you a Memorandum containing the comments of the Mission on the draft Monetary Law.

The Mission's views on the other two draft laws were expressed in its Second Report.

Sincerely yours,

H. D. White,
Chief of Mission.

Honorable Oscar Garcia Montes,
Minister of Finance,
Habana, Cuba.

AMERICAN TECHNICAL MISSION TO CUBA

Comments on the Draft Monetary Law

The following comments pertain to the draft Monetary Law submitted by Minister Garcia Montes to the Mission on the occasion of his visit to Washington in March 1942. The Mission has examined the draft Monetary Law from the point of view of its compatibility with the Mission's recommendations as presented in its Second Report to the Cuban Government and also from the point of view of the principles which the Mission feels should be embodied in the Monetary Law.

GOLD CONTENT OF THE PESO

The Mission agrees that it is desirable to define the peso in terms of gold and that a gold content equal to that of the United States dollar is appropriate for the Cuban peso. The weight of the United States gold dollar was fixed at 15-5/21 grains of gold 9/10 fine by Presidential Proclamation of January 31, 1934. This is equivalent to 0.987412+ grams of gold 9/10 fine or 0.888671- grams of fine gold. Article 1 of the draft Monetary Law specifies that the Cuban gold peso shall have a weight of 0.9873 grams and Article 5 that gold coins shall have a fineness of 9/10, which makes the gold content of the Cuban peso slightly less than that of the United States dollar. It might be more convenient if the two gold contents were exactly equal.

COINAGE OF GOLD

The Mission agrees that a prohibition against coinage of gold such as is contained in Article 8 is desirable. At present gold is used primarily for settling international balances and for monetary reserves. The use of gold as a medium of hand-to-hand circulation has almost completely disappeared.

ISSUE OF GOLD CERTIFICATES

Article 8 also provides that the President of the Republic shall be empowered to issue gold certificates and that such gold certificates shall be used only for exchange at the Central Bank for currency having legal circulation privileges. In its Second Report the Mission made recommendations giving the Bank sole power to issue currency and outlining means available to the Stabilization Fund for financing acquisitions of gold. The Mission believes that provisions pertaining to the issue of obligations secured by gold and foreign exchange can more appropriately be included in those portions of the Central Bank Law which are concerned with the Stabilization Fund.

PRIVATE OWNERSHIP OF GOLD

Paragraph 1 of Article 15 in effect prohibits the private ownership and holding of gold in Cuba. A number of other countries have adopted similar measures designed to prevent the hoarding of gold. It may be observed, however, that a prohibition against private gold holding would not prevent Cubans from hoarding dollars either in Cuba or

in the United States and that measures designed to do so would be incompatible with a free exchange market.

GOLD PURCHASES BY THE GOVERNMENT

Paragraph 1 of Article 15 also requires redemption of gold in "coins of legal circulation." This appears to be an unnecessarily inconvenient method of payment. It would probably be better to eliminate any reference to the form in which payment should be made, thus permitting payment in legal tender currency as well as in coins, or payment by check if that is agreeable to the person whose gold is being redeemed.

Paragraph 2 of Article 15 requires that the Cuban Government purchase all gold which is offered to it and specifies the price at which gold shall be acquired. The Mission agrees that if private holding of gold is to be forbidden, the Cuban Government should stand ready to purchase all gold surrendered by residents of Cuba. The Mission does not believe, however, that the Cuban Government should be required to purchase all gold offered to it, at home or abroad, without regard to the amount or to conditions which might from time to time develop. It may be noted that the United States Treasury and Stabilization Fund are not so obligated.

CHANGES IN THE PRICE OF GOLD

Paragraph 3 of Article 15 provides that the President of the Republic shall have power to modify the price of gold and the gold content of the peso but not below 0.8359 grams (presumably of gold 9/10 fine). This gives the President

power to devalue the peso by as much as 15 percent or to appreciate it without limit.

The Mission has recommended in its Second Report that the Stabilization Fund be required to maintain the peso at parity permitting only minor technical fluctuations within a range of not more than 2 percent in either direction. The Mission, however, has also stated its belief that the Stabilization Fund Committee should be empowered to recommend to the President of the Republic the adoption of a new parity level with a corresponding change in the gold content of the peso if circumstances appear to require a basic adjustment of Cuba's exchange rate. If he agrees the President should then ask the Cuban Congress for the necessary legislation to change the gold content of the peso. To prevent flight of capital in a period during which devaluation of the peso was being considered, it might be necessary temporarily to subject foreign exchange transactions to control by license. A recommendation providing for just such a step in this contingency was included by the Mission in its Second Report.

There is one circumstance in which prompt executive action may be desirable. By powers conferred in the Act of May 12, 1933, as amended by the Gold Reserve Act of 1934 and by subsequent extensions of these powers, the President of the United States is authorized to fix the

weight of the gold dollar between 50 and 60 percent of its former gold content. By proclamation of January 31, 1934, the President fixed the weight of the gold dollar at 59.06 percent of its former content. However unlikely the contingency that these powers to alter the gold content of the dollar will again be exercised, so long as they remain in effect the President of Cuba should probably be authorized to revise the gold content of the peso and the peso price of gold in the event of similar action by the United States and to an equivalent extent. Since quick action may be required, exercise of this authority should probably not be subject to the necessarily slower process of Congressional approval.

REGULATION OF GOLD TRANSACTIONS

The Mission agrees that provisions similar to those contained in Articles 16, 17, 18, 19, 20, 22 and 23 regulating transactions in gold are necessary if private holding of gold is to be forbidden. It suggests, however, that this entire group of provisions be reviewed in the light of the role contemplated for the Stabilization Fund in the Mission's Second Report. Article 22 contains a reference to Article 16 which presumably should be a reference to Article 15.

Under the Mission's recommendations in its Second Report, powers similar to those in Article 21 (authorizing the Central Bank to receive and hold gold) and Article 24

(authorizing the Finance Minister to deal in gold, foreign exchange, or other credit instruments for the purpose of stabilizing the exchange rate) are provided in the Central Bank Law and do not need to be repeated in the Monetary Law. In several respects these Articles differ from the recommendations made in the Second Report.

PROPORTION OF SILVER TO GOLD IN THE MONETARY STOCKS

The Mission believes it is unnecessary in the Monetary Law to raise the problem of the relative size of the gold and silver stocks as is done in Article 3 or to provide means for withdrawing silver from the monetary stocks as is done in Article 14. The Mission has included recommendations on these matters in its Second Report. In the opinion of the Mission, this entire problem can best be handled in the Central Bank Law. Accordingly, the Mission suggests the deletion of Articles 3 and 14 from the Monetary Law. While the Mission favors the acquisition by Cuba of adequate reserves of gold or foreign exchange, it considers that operations for this purpose should be carried out by the Stabilization Fund and that no legal declaration on the proportion of gold and silver (such as that made in Article 3) is required.

ISSUE OF SILVER CERTIFICATES

In view of the fact that the Mission contemplates the ultimate replacement of all silver certificates by Central Bank notes, the Mission recommends the omission from the Monetary Law of Article 12 which provides for further issues of silver certificates.

FRACTIONAL COINS

The Mission approves the proviso in Article 9 that silver needed for coinage of fractional silver coins shall be obtained, unless circumstances indicate otherwise, from the stock of one-peso silver coins. Under the Mission's recommendations in its Second Report the silver coins will be in the possession of the Central Bank, unless the silver has been sold through the mechanism suggested in that Report, and will be available to the extent to which silver certificates have been retired. In the event that the Government obtains the silver needed for fractional coinage from the one-peso coins held by the Central Bank, the Mission presumes that the Government will reimburse the Bank by making payment in cash for the bullion value of the silver at the current market price and in non-interest-bearing and non-maturing Government securities for the difference between the bullion and the monetary value. For reasons of flexibility and when circumstances warrant, it may be desirable to authorize the Finance Minister also to buy silver for coinage purposes in the open market.

The Mission believes that the power to order the minting of fractional coins should be vested in the Finance Minister but that he should be authorized to exercise this power only to replace worn-out coins or to meet the needs of circulation, including the accumulation of a reasonable

reserve stock of coins, after consultation with the Central Bank. This recommendation necessitates appropriate changes in Articles 9 and 10.

SUBSTITUTION FOR NICKEL IN COINS

In view of the current shortage of nickel, which presumably will continue until the end of the war, the Mission believes it may be desirable to include in the Monetary Law authorization for the coinage of small fractional coins containing no nickel. Just what materials will be available during the war cannot now be specified. Therefore, a flexible authorization to use any appropriate materials would avoid the need for later, special authorization. This recommendation will necessitate appropriate changes in Articles 2, 5, 6, 10 and 11.

EXCHANGE CONTROL

Article 25 of the proposed Monetary Law provides that whenever the Central Bank reserves fall below 40 percent and measures to restore the reserves to the legal minimum prove ineffective, the President may forbid foreign exchange transactions, provided an emergency exists. In its Second Report the Mission recommended that in an emergency and upon the recommendation of the Stabilization Fund Committee, the President of the Republic be empowered to subject foreign exchange transactions to license by the Finance Minister. In addition, the Mission has recommended that whenever Central Bank reserves fall below the legal minimum the Central Bank must pursue a corrective policy satisfactory to

the Advisory Council. In view of these recommendations, the Mission believes that Article 25 and Article 26, which are related, should be omitted from the Monetary Law.

MUTILATED CURRENCY

Article 13 outlines rules for redemption of mutilated silver certificates. Since no mention of Central Bank notes is made in Article 13, the Mission presumes it is the intention of the Cuban Government that the Central Bank shall frame its own rules for redemption of its own mutilated notes. However, since the Bank's notes are being made legal tender, it seems desirable to have the Government lay down rules for the redemption of mutilated notes. This can be done by applying to Central Bank notes the rules on mutilated silver certificates.

DOLLAR EXCHANGE RATE

The last paragraph of Article 27 forbids the collection of any amount, premium or compensation in excess of the exchange rate quoted by the Central Bank at the time of the transaction, in converting into Cuban pesos the dollar deposits or accounts existing at the time the proposed Monetary Law comes into force. In the opinion of the Mission, the last paragraph of Article 27 should be omitted. There does not appear to the Mission to be any good reason for writing into the law rigid restrictions on the exchange rate at which dollar deposits or accounts may be converted into pesos. The Mission has proposed that the Exchange Stabilization Fund rather than the Central Bank shall assume

responsibility for the exchange operations essential to the stabilization of the peso. There will, therefore, be no occasion for the Central Bank to quote a current exchange rate for the peso. Moreover, having in mind the secrecy with which the Exchange Stabilization Fund must carry on its operations in the exchange market, the Fund will ordinarily not publicly quote an exchange rate. Unless it becomes necessary to adopt exchange licensing, holders of dollar deposits or other foreign-currency deposits should be permitted to convert them into pesos at the rate of exchange prevailing in the foreign exchange market at the time the conversion is made.

DELETION OF SUPERIOR BANKING COUNCIL

The draft Monetary Law refers to the Superior Banking Council in many places and gives several important powers to this body. The Mission's Second Report contemplates the establishment of an Advisory Council with restricted functions and powers in lieu of a Superior Banking Council. This necessitates review of a number of paragraphs of the draft Monetary Law from this point of view. In most cases, however, the nature of the necessary revision has already been indicated in preceding paragraphs.

The Superior Banking Council is referred to in Articles 3, 9, 10, 12, 15, 17, 24, 25, 26 and 28. In this memorandum the Mission has suggested the deletion of Articles 3, 12 and 24 (among others) thus eliminating the

necessity for considering changes in these Articles. Articles 9 and 10 require advice of the Superior Banking Council in connection with coinage of fractional coins by the President of the Republic. The Mission has recommended that this power be vested in the Finance Minister without reference to the Advisory Council. Article 15 makes the President's authority to change the price of gold subject to a recommendation by the Superior Banking Council. The Mission has recommended that in the event of a change in the gold content of the United States dollar, the President be authorized to make a similar change in the gold content of the Cuban peso. For changes under all other conditions legislative action should be required to alter the gold content of the Cuban peso. Article 17 subjects the Finance Minister's authority to prescribe rules respecting transactions in gold to action by the Superior Banking Council. The Mission does not believe that the consent and advice of the Advisory Council is necessary in this connection. Article 25 requires action by the Superior Banking Council in connection with the imposition of exchange control by the President. The Mission recommended in its Second Report that the President be authorized to subject foreign exchange transactions to license by the Finance Minister upon the advice of the Stabilization Fund Committee. Article 26 gives the

Superior Banking Council as well as the Finance Minister the right to require testimony under oath in connection with the establishment of exchange control. The Mission has not recommended that the Advisory Council be given similar authority but agrees that the Finance Minister should have such authority. Article 28 specifies that the Superior Banking Council may determine the date when the legal tender power of United States currency shall cease. The Mission has not given the Advisory Council this authority and instead has suggested that the legal tender power of United States currency cease immediately (presumably upon the entry into force of the legislation incorporating the recommendations of the Second Report).

American Technical Mission to Cuba

COMMENTS ON THE DRAFT BANKING LEGISLATION

Fourth Report to the Cuban Government

July 15, 1942

Personnel of Mission

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H. D. White, Chief of Mission, Treasury Department

AMERICAN TECHNICAL MISSION TO CUBA

July 15, 1942.

Dear Mr. Minister:

I am transmitting to you herewith the American Mission's Fourth Report to the Cuban Government, containing comments on the Draft Banking Legislation, which you forwarded to the Mission in June. The members of the Mission have examined this Draft Legislation and prepared comments thereon in accordance with the request in your letter of June 5, 1942.

These comments serve primarily to clarify the recommendations presented by the Mission in its Second Report. In those instances where the provisions of the Draft Law differ from the recommendations of the Second Report and where the Mission in commenting thereon has indicated a preference for its original recommendations, the reiteration of the Mission's original position is not intended to convey insistence upon its ideas but simply to indicate that the Mission has not changed its mind with respect to these matters. The Mission recognizes that the solution to certain types of problems can best be left to the judgment of Cuban officials thoroughly familiar with the local situation.

Some sections of the proposed Legislation contain matters on which the Mission did not comment in its Second Report. On most of these matters the Mission did not have an opportunity to make a thorough study of the problems involved. In these cases, therefore, the Mission is making certain general comments and is making specific observations only where for particular reasons they appear to be appropriate. The Mission wishes to emphasize that absence of comment on provisions in these particular sections does not imply approval by the Mission.

In transmitting these comments the Mission wishes to express its appreciation to the Cuban Government for its courtesy in sending the proposed Legislation for comment by the Mission.

Sincerely yours,

H D White

H. D. White,
Chief of Mission.

Honorable Oscar Garcia Montes,
Minister of Finance,
Habana, Cuba.

Comments on the Draft Banking Legislation

Fourth Report to the Cuban Government

The American Technical Mission in response to the request of the Cuban Finance Minister has examined the draft Banking Legislation which the Finance Minister submitted to it. The present report contains the Mission's comments on certain features of this Draft Law which are hereby submitted for the consideration of the Cuban Government.

In thus commenting on the Draft Law, the members of the Mission do not wish to give the impression that they have been able to make an exhaustive study of the draft. For the most part, they have confined their attention to those portions of the Draft Law, primarily Titles I, II, III and VII, which are concerned with material embodying the recommendations in the Mission's Second Report to the Cuban Government.

The Mission did not have an opportunity to study the problem of bank inspection or of the regulation of private banks in Cuba and, therefore, has not made detailed comments on the provisions relating to these matters. The Mission's comments on Titles IV and V are, therefore, confined to general observations except in the case of matters related to the Mission's Second Report or matters which, for other reasons, appear to merit special attention.

The Mission has in general not attempted in this report to examine questions of drafting nor has it undertaken to review matters of operating or legal detail or other matters of lesser importance.

The comments of the Mission on the Draft Law follow below:

Title I: The Superior Banking Council.

The Mission observes that in this title and throughout the entire Draft Law, powers are granted to the Superior Banking Council far in excess of those which the Mission recommended for the Advisory Council proposed in its Second Report. The members of the Mission are still strongly of the belief that a powerful Superior Banking Council superimposed on the Central Bank is not advisable.

The Mission observes that the powers and duties of the Superior Banking Council as listed in Title I, Chapter 2, Article 8, are largely duplicated elsewhere in the Draft Law and in their present form, of course, considerably exceed those which the Mission would be in favor of granting to an Advisory Council or Superior Banking Council. Regardless of what powers and duties are finally conferred upon the Council, the material in Article 8 could be eliminated to avoid duplication. The Mission wishes particularly to call to the attention of the Cuban officials the fact that both Article 1, Chapter 1, and Article 8, Chapter 2, specify that the Superior Banking Council shall direct monetary and banking policy -- a grant of power which in the Mission's opinion should be reserved to the Stabilization Fund and Central Bank.

Title II, Chapter 2, Article 9.

The provision in Article 9 requiring an initial subscription by new banks to at least 500 shares of Central Bank stock appears to be

excessive. This would necessitate an investment in Central Bank stock of at least 50,000 pesos and is probably considerably more than would be required of a small new bank by the 2 percent provision which would govern the new bank's subscription to Central Bank stock during the second year of the new bank's existence. Elsewhere in the law (Title V, Chapter 3, Article 25) provision is made for the establishment of banks in small municipalities with a minimum authorized capital of 50,000 pesos. Banks established with this minimum capital would be compelled by Article 9, Chapter 2, Title II to invest their entire capital in Central Bank shares during the first year of their existence.

The Mission believes that this requirement would be unduly burdensome for small new banks. The Mission recognizes that the establishment of new banks should be permitted only with adequate safeguards but does not believe that this restriction in its present extreme form serves a useful purpose. Accordingly, the Mission recommends the elimination from Article 9 of the proviso requiring initial subscription to at least 500 shares.

Title II, Chapter 6, Article 22.

The Mission notes that Article 22 makes no provision as to the manner in which the panels specified in Article 22 are to be selected. The Mission made no recommendation on this particular point in its Second Report feeling that the solution to this type of problem should be left to the judgment of the Cuban officials responsible for drafting

the proposed banking legislation. In the absence of such a provision, however, there may be some uncertainty as to what constitutes valid election to a panel.

Title II, Chapter 6, Article 23.

This article makes the Inspector General of Private Banking the mandatory alternate for the Finance Minister on the Board of Directors of the Central Bank. The Mission repeats its suggestion that the Finance Minister should be allowed to select his own alternate.

Title II, Chapter 6, Article 27.

This article requires that members of the Board of Directors must reside in the City of Havana or within a radius of not more than 100 kilometers from Havana. The Mission feels that individuals residing elsewhere in Cuba might also make good directors for the Central Bank, and that their exclusion on grounds of residence is an unnecessary discrimination. Article 26 takes care of the problem of frequent absences of directors from meetings of the Board. In view of the existence of Article 26, the Mission does not believe that Article 27 is necessary or desirable.

Title II, Chapter 6, Articles 28 and 29.

The third paragraph of Article 28 specifies that class B directors holding Government positions for which they are drawing salaries shall not be entitled to additional allowances for attendance upon meetings of the Board of Directors. The Mission believes that it would probably

be best to prohibit paid Governmental office holders from becoming Class A or B directors of the Bank. Accordingly, the Mission suggests the elimination of the last paragraph from Article 28 and the revision of Article 29 to make it applicable to all types of Governmental positions instead of merely to elective offices. This revision could be accomplished merely by deleting the word "elective" from the paragraph.

Title II, Chapter 7, Article 32, Paragraphs b, m, and r.

The Mission notes that paragraph r of Article 32 provides for the delegation only of the powers specified in paragraph m, namely, the authority to purchase materials and furniture necessary to the operation of the Bank. From provisions elsewhere in the law, it appears that other powers and duties of the Board of Directors can be delegated. Article 35, Chapter 8, for example, provides that the Governor of the Bank may exercise functions delegated to him by the Board. Paragraph b of Article 32 and Articles 39 and 40 provide that the Board may establish discount and other committees and confer powers upon them. It may be advisable to modify Article 32 so as to give the Board general authority to delegate powers or so as to specify more clearly and accurately what powers and duties of the Board can be delegated.

Title II, Chapter 7, Article 32, Paragraph t.

This paragraph provides that the Board may recommend to the Superior Banking Council the amount of the service charge or commission which shareholding banks shall be allowed to levy upon depositors in the event

of an increase in the legally required reserves. The Mission believes that this entire matter should be left to the discretion of the member banks themselves and that the Superior Banking Council should, therefore, not be given authority to regulate the amount of such service charges. Accordingly, the Mission recommends the deletion of paragraph t from Article 32.

Title II, Chapter 10, Article 42.

The Mission notes that the third paragraph of Article 42 refers to the total indebtedness of the Government and provides that when this indebtedness has reached 10 percent of annual average budgeted expenditures for the current and preceding fiscal years, the Bank's authority to make additional advances becomes restricted. In its initial recommendation the Mission stated that this proviso should apply not to the total indebtedness of the Government but to the total indebtedness of the Government to the Central Bank under extensions of credit of the type contemplated in Article 42 and 43(q). The Mission, therefore, suggests that the third paragraph of Article 42 be revised to apply only to the total debt of the Government to the Central Bank under such advances.

Title II, Chapter 10, Article 43, Paragraph d.

This paragraph provides that the Bank may rediscount agricultural paper but limits the maturity of such paper to 180 days. The Mission feels that when an agricultural bank is established in Cuba it should probably be given rediscount facilities at the Central Bank on paper with maturities up to 270 days. With this in mind, the Mission sees

no reason why agricultural paper with the endorsement of a shareholding bank should not be permitted to run for 270 instead of 180 days. It should be noted that this proposal differs from that in the Mission's Second Report. This difference arises from the Mission's further study in the course of preparing the report on agricultural credit which it will shortly submit to the Cuban Government.

Title II, Chapter 10, Article 43, Paragraph h.

This paragraph provides that the Central Bank may rediscount, with the endorsement of the shareholding bank, the obligations and debentures of official credit institutions provided that their maturity is not in excess of 180 days from date of discount. Inasmuch as no such official credit institutions now exist and in view of the difficulties of anticipating the precise credit needs of such institutions it seems preferable to provide that the maturity of the obligations and debentures of official credit institutions eligible for rediscount by the Central Bank shall be determined at the time each such institution is created.

Title II, Chapter 10, Article 43, Paragraph i.

This paragraph authorizes the Central Bank to buy and sell obligations issued by official credit institutions of the same type and conditions described in paragraph g provided that the total invested in the obligations of a given institution shall not be in excess of 15 percent of the total assets of the Bank. In view of the difficulties of determining the credit needs of official credit institutions which

are not now in existence the Mission proposes that this paragraph be reworded somewhat as follows:

> "To buy and sell obligations issued by and to make advances to and rediscounts for official credit institutions upon terms and conditions to be specified in legislation establishing each such institution, provided, however, that the total invested in obligations of a given official institution shall not be in excess of 15 percent of the total assets of the Bank."

It should, of course, be understood that this proviso is not intended to limit open market purchases and sales of the seasoned obligations of such institutions under the limitations prescribed elsewhere in the Central Bank statute.

Title II, Chapter 10, Article 45.

This article provides that the Bank may establish limitations on the total indebtedness of any one person or firm to a bank. A similar provision is found in Title V, Chapter 2, Article 17. The Mission feels that a limitation of this kind should not be left to the discretion of the Central Bank. The Mission also feels that a precise limitation should not be written into the law until the Central Bank has gained some experience with this aspect of banking supervision which may provide a guide to legislation. These comments apply to the articles in both Titles II and V.

Title II, Chapter 11, Article 49.

The precise meaning of the second paragraph of this article is not entirely clear, at least in the English translation. The Mission presumes it is not intended to require that the Bank hold an amount of eligible paper equal to the difference between the metallic reserve (gold, silver, and foreign exchange) and the nominal value of the Bank's notes, as might be implied by the text.

Title II, Chapter 11, Article 54.

This article provides that the Bank may increase the rediscount rate whenever the gold and foreign exchange reserve behind bank notes becomes lower than the minimum proportion fixed in the law. The Mission believes that this article is unnecessary and should be omitted. In its Second Report the Mission recommended that whenever the legal reserves of the Bank fall below the required level, the Bank's policy should become subject to review by the Advisory Council (or Superior Banking Council) and that unless authorized to the contrary by the Council, the Bank should immediately undertake measures to restore the required reserve ratio. The Mission also recommended that if the Council is not satisfied with the measures adopted by the Bank, it should have the authority to require the Bank to alter its program. These recommendations are largely embodied in other provisions of the draft legislation under review. It seems unnecessary to separate out for special comment one of the measures

which might be adopted to combat a reserve deficiency. Article 54 appears to be permissive rather than mandatory. As a permissive measure, it is unnecessary because the power is granted elsewhere. As a mandatory measure, it would be undesirable because there might be occasions when it would be unwise to raise the rediscount rate despite a reserve deficiency.

Title II, Chapter 12, Article 55.

The fourth paragraph of this article provides, among other things, that the reserve against deposits in foreign currency at the Bank may be composed of United States currency. In its Second Report, the Mission recommended that against its deposit liabilities in dollars, the Bank should be required to keep a 100 percent cover of high-grade liquid dollar assets. It appears unnecessary in the statute establishing the Bank to specify that this 100 percent cover may consist of United States currency. It is not entirely clear whether the third paragraph requires that the 100 percent cover be in United States currency or merely provides that it may be in United States currency. In either event, it appears unnecessary to single out dollar currency as the form which this reserve should take.

Title II, Chapter 12, Article 56.

This article specifies, among other things, that in the event of a reserve deficiency, the Bank should immediately adopt measures for restoration of the reserve to the legal level. It was pointed out above that the Mission's Second Report exempted the Bank from this requirement

in the event of express authorization by the Advisory Council or Superior Banking Council. While the Mission agrees that in general the Bank should be required to take immediate steps to correct a reserve deficiency, it still feels that there may be circumstances when immediate action of this character would be injurious to the economy and that, therefore, the Council should have power to authorize other action by the Bank.

Title II, Chapter 12, Article 57.

Paragraph a of this article specifies that series A Treasury obligations shall be delivered by the Government to the Bank at a discount of 1 percent. The Mission believes this to be a misinterpretation of its previous recommendations. In its Second Report, the Mission recommended that the Government turn over to the Bank special Treasury securities with a face value of 3,030,000 pesos. It was the belief of the Mission that these special securities could probably be sold in the market at a discount of roughly 1 percent and that, therefore, the Bank as a matter of conservative accounting practice could well carry these securities on its books at a valuation of about 3 million pesos although they would have a face value 30,000 pesos greater. The Mission did not have in mind the delivery of these securities by the Government to the Bank at a discount of 1 percent as is apparently required in paragraph a of Article 57.

The Mission believes that Article 57 relating as it does to the capital of the Bank should probably be placed in Chapter 2, Title II along with the other provisions respecting the Bank's capitalization.

In its Second Report the Mission indicated that in the event the capital surplus of the Bank was reduced to 1 million pesos, the Government should be required to restore the capital surplus to a level of 3 million pesos. A provision to this effect is not included in Article 57 or in the articles of Chapter 2 relating to the capital structure of the Bank. The Mission suggests the possible addition of a provision to this effect either to Article 57 or to some other appropriate article in Chapter 2.

In a letter addressed to the Cuban Finance Minister subsequent to the transmission of the Mission's Second Report to the Cuban Government, the Mission suggested the possibility of a proviso that the Government be required to maintain the capital stock of the Bank at 5 million pesos in the event that the combined share capital plus paid-in and earned surplus drop below 7 to 8 million pesos. This suggestion was made in response to an indication to the Mission that the Cuban public might interpret a decline in the total capital of the Bank as a sign of weakness. The Mission notes that none of the articles of Chapter 2, Title II relating to the Bank's capital contain reference to this particular suggestion. The Mission does not wish specifically to recommend the inclusion of such a proviso in Chapter 2 but merely wishes to call attention to its absence. On a matter of this kind involving the reaction

of the Cuban public to a reduction in the capital of the Bank, the Mission wishes to defer to the judgment of the responsible Cuban officials.

Title II, Chapter 12, Article 58.

The Mission believes that this article, as well as Article 57, should probably be included with the material in Chapter 2, Title II referring to the Bank's capitalization.

Title II, Chapter 13, Article 60.

This article provides that in the event of a deficiency in the reserves of member banks, these banks may not pay dividends or make new loans or investments until their reserves have been restored to the legal level. The Mission believes that this provision should be deleted. A similar provision existed in the United States Federal Reserve Act for many years but proved to be unworkable and has recently been eliminated from the law. It was eliminated because bank directors were subject to personal liability for making loans or paying dividends while reserves were deficient even though in many instances they could not know at the time they were making loans whether reserve deficiencies existed since reserve requirements are normally computed only periodically.

The Mission recognizes the desirability of imposing upon commercial banks some penalty for failure to maintain reserves at the legally required level. In place of the provision of Article 60, the Mission suggests the possibility of adopting a penalty provision somewhat similar to one currently in use in the United States Federal Reserve

System. Under this provision, member banks are required to pay a penalty on the amount of the deficiency. As one possibility, the Mission suggests that on deficiencies persisting up to 15 days the member banks be required to pay a penalty at the rate of 2 percent above the Bank's highest rediscount rate, and that on deficiencies persisting longer than 15 days, the penalty be increased to 5 percent above the rediscount rate. These penalty rates are meant to be rates per annum and would accordingly be adjusted to the length of time the reserve deficiency persisted.

Title II, Chapter 14, Article 63.

The Mission interprets this article to specify that dividends on shares shall be cumulative at 3 percent and shall not exceed 4 percent. The Mission intended that these provisions should apply only to shares held by member banks and not to the shares held by the Government.

Title II, Chapter 16, Fourth Provision.

This paragraph provides that the Bank shall contribute to the expenses of the office of the Inspector General of Private Banking. As will be indicated below, the Mission seriously doubts the wisdom of establishing an elaborate and a separate organization for the inspection of private banks. In view of this fact, the Mission doubts the necessity or desirability of this provision.

Title II, Chapter 16, Fifth Provision.

This paragraph relates to the extension of Central Bank credit to official credit institutions. Since this subject matter is covered in Title II, Article 43, paragraph i, the Mission suggests the desirability of combining the material in the Fifth Provision with paragraph i.

The Mission notes that under the Fifth Provision, the power to increase the limit on extensions of credit by the Central Bank to official credit institutions from 15 to 20 percent of the Bank's assets is vested exclusively with the Board of Directors of the Bank after a period of 2 years. The Mission's original recommendation subjected such action by the Board of Directors to the approval of the President of the Republic. The Mission still feels that this is a matter of sufficient importance to subject the action of the Board of Directors to review by the President of the Republic.

Title III, Chapter 1, Article 2.

This article specifies that the Inspector General of Private Banking shall be a member of the Commission managing the Stabilization Fund. The Mission's views respecting the appointment of an Inspector General of Private Banking will be expressed below. Regardless of whether or not such an office is to be established, the Mission does not believe that an inspector of private banks would be the appropriate official as the third member of the Stabilization Fund Committee. The Mission, therefore, refers to its original recommendation providing that the third member of this Committee be appointed by the Finance Minister.

Title III, Chapter 1, Article 3, Paragraph c.

The wording of this paragraph at least in its English translation is not entirely clear. The Mission assumes that the obligations referred to would be guaranteed by a pledge of gold or foreign exchange. In its present wording, however, this paragraph could conceivably be interpreted so as not to require such a pledge. It is assumed, further, that this paragraph does not prohibit the substitution of the Bank's notes for gold or foreign exchange as collateral for Stabilization Fund obligations, as is envisaged in Title II, Chapter 10, Article 43, paragraph j. Obligations backed by Bank notes would of course not be eligible to serve as reserve behind the note and deposit liabilities of the Bank, as is made clear in Title II, Chapter 12, Article 55.

Title III, Chapter 1, Article 5.

The third paragraph of this article provides that the Bank may discontinue financing the Fund and require a reduction in its overdraft whenever justified fears of an undesirable credit expansion exist. In its Second Report the Mission suggested that such action by the Bank should require the affirmative vote of at least 5 members of the Board of Directors. The Mission notes the absence of this provision from the Draft Law under review and suggests the inclusion of a provision to this effect in Article 5.

The Mission further suggested that the Bank should be free to use this power over the Fund overdraft whenever it deems it advisable. The

Mission pointed out, for example, that "when for reasons of credit policy only a limited amount of Central Bank credit can be made available to the Central Government, official credit agencies, and the Fund combined, it may be a net saving to the Government as a whole if the Fund is financed partly in the open market, leaving the available Central Bank credit to the Government or the lending agencies. Thereby obligations bearing the lowest rates of interest would be sold to the open market while obligations bearing higher rates of interest would be bought by the Central Bank. Since the Government is the residual beneficiary of Central Bank earnings, this procedure would reduce the Government's net cost of borrowing." It is possible that such action could be taken on the grounds of "justified fears of an undesirable credit expansion", but the Mission believes that this might involve a somewhat forced interpretation since the only undesirable credit expansion that the Bank could fear would be that which it was itself considering creating. The Mission, therefore, suggests adoption of the less restrictive phrase used in its Second Report -- namely, "whenever the Central Bank deems it advisable."

Title III, Chapter 1, Article 6.

This article specifies that Stabilization Fund certificates may not have a maturity in excess of 120 days. The Mission sees no particular reason for placing a precise limit of this kind upon the maturity of Stabilization Fund obligations.

Titles IV and V.

The Mission has not given careful study to Titles IV and V. Neither did it have occasion or opportunity in Cuba to investigate the problems of bank inspection and regulation of private banking activities. For these reasons the Mission is not making detailed comments on most of the material in Titles IV and V.

The Mission. does, however, wish to express its conviction that Cuba does not need an elaborate and costly organization separate from the Central Bank to inspect and regulate private commercial banks. In its Second Report the Mission commented to the effect that the Central Bank should have power to require examinations and statements of condition of banks audited by public accountants and that it should be empowered to authorize or prohibit the opening of new banks and branches. If in the judgment of Cuban officials it is desirable to establish some regular machinery for examining banks, it is the firm conviction of the Mission that this function can best be entrusted to the Central Bank. This will give the Bank regular and complete information respecting banking developments in Cuba. The Bank would probably have access to such information anyway but may get it more easily and systematically through this channel. Moreover, the Bank may be able to perform bank examinations at less cost than a separate organization because it will not be necessary to duplicate expensive managerial services. Cuba has relatively few banks and examination of these (even with all their branches) should not require a large organization.

In addition, the Mission wishes to express its firm conviction that the powers granted to the Inspector General of Private Banking in Titles IV and V are excessive and extreme. For example, Title IV, Chapter 2, Article 4, paragraph d permits the Inspector General to determine the maximum amount a bank may invest abroad. The Mission regards it as undesirable for the Inspector General to have this power with respect either to domestic or foreign banks but particularly so in the case of the foreign banks. Another example of an unnecessarily broad grant of power to the Inspector General is found in Title V, Chapter 2, Article 4. The second paragraph of this article gives the Inspector General power to effect changes in the business of banks and their manner of operation even prior to the promulgation of the Banking Law if he deems this necessary in the public interest.

As stated previously, the members of the Mission have not had an opportunity to make an adequate study of the problems of bank inspection and bank regulation in Cuba. The Mission's examination of the present draft of Titles IV and V, together with its knowledge of American experience in bank examination and regulation, leads it to feel that further study of these two problems would be advantageous before definitive legislation is provided. In the following pages the Mission has commented on a few paragraphs in the two Titles as now drafted as an indication of some of the matters with which further study might be concerned. In addition, some of the comments relate to sections in

these two Titles which are concerned with matters taken up in the Mission's Second Report.

Should it be decided to postpone enactment of Titles IV and V as now drafted, it may be desirable to transfer to Titles I, II, or III certain provisions relating to the Central Bank. As examples of these may be cited Article 8 of Chapter 2 in Title IV, and Article 15 of Chapter 2 in Title V.

Title IV, Chapter 2, Articles 8 and 9.

Article 8 provides that the Inspector General shall prepare and publish statistics relating to the Central Bank, foreign exchange, and banking. This is a function which in the opinion of the Mission should be delegated to and performed by the Central Bank.

Article 9 empowers the Inspector General to require data and information from practically any and all parties. Stated in this way the power is much too broad and inclusive.

Title V, Chapter 1, Article 1.

With respect to this article defining banks, the Mission suggests that banks do not necessarily perform all the functions there specified and that financial houses performing only some of these functions are not necessarily banks.

Title V, Chapter 2, Article 15.

Article 15 provides that the Superior Banking Council may vary the proportion of legally required reserves within a range of 12½ percent

to 40 percent. In addition, it authorizes the Superior Banking Council to require higher reserves on deposits in excess of those existing when the increase is ordered whenever excessive credit expansion is threatened. The Mission regards it as preferable to entrust the power to raise reserve requirements exclusively to the Central Bank and believes that such power should be restricted to deposits in excess of those existing when the measure is imposed. The Mission feels that Article 15 gives too much authority to the Superior Banking Council. It also feels that the proviso permitting variation between 12½ percent and 40 percent in the reserves against all deposits is objectionable because it subjects the banks to wide and sudden fluctuations in requirements and because it is retroactive in the sense that it applies to deposits long since acquired. In brief, the Mission is of the opinion that for Cuba a provision respecting increases in reserve requirements of the type recommended in the Second Report is preferable to the type proposed in this article.

Title V, Chapter 2, Article 16.

This article requires that 40 percent of the profits of a commercial bank be turned in to a contingent reserve until the reserve shall have reached an amount equivalent to 50 percent of the subscribed and paid-in capital. The Mission believes that this requirement is too stringent. Moreover, it suggests that in connection with the branches of foreign banks operating in Cuba which may have no specified

capitalization apart from that of their head offices, a provision of this kind will create difficulty.

Title V, Chapter 2, Article 18.

This article specifies that private commercial banks may not maintain balances abroad or make investments abroad in excess of proportions to be established by the Central Bank. A somewhat similar proviso is included in Title IV, Chapter 2, Article 4, paragraph d, which specifies that the Inspector General of Private Banking may determine the maximum amount which banks may invest abroad and the maximum balances which they may maintain abroad. Apart from the conflict of authority here between the Central Bank and the Inspector General of Private Banking the Mission wishes to express its conviction that this constitutes too broad a grant of power. Banks must be permitted to maintain dollar assets equal to their dollar liabilities and in the absence of exchange control should be permitted to invest their dollar funds in dollar assets with relative freedom.

Title V, Chapter 2, Article 19.

This article specifies that the foreign currency deposits of banks shall be limited to 10 percent of their total deposits. In its Second Report, the Mission recommended that the legal tender status of the dollar should be ended at once but suggested that other impediments against the use of dollars would probably not be in Cuba's interest at this time. In addition, it suggested that for a period of five years,

banks should be permitted to hold dollar reserves against dollar deposits but that at the expiration of this period all their legal reserves should be exclusively in pesos. The Mission still feels that these provisions constitute both an ample discouragement against exclusive reliance upon dollar deposits, and at the same time, a guarantee of fair treatment to the banks and to depositors with respect to their dollar deposits. The Mission feels that the 10 percent requirement in Article 19 is unnecessary and unduly restrictive. In addition, it believes that the proviso of Article 19 giving to the Superior Banking Council the power to change this percentage is undesirable for the reason that it grants to the Superior Banking Council an undue degree of power.

Title V, Chapter 2, Article 23.

This article empowers the Superior Banking Council to seize banking establishments in the event of certain specified circumstances. In general, the Mission believes that it is unwise to make the Superior Banking Council a prospective receiver of banking properties.

In particular, the Mission wishes to express its belief that paragraph e of Article 23 is unwarranted. This paragraph provides for the seizure of banking properties by the Superior Banking Council in the event that a private commercial bank does not maintain with the Bank of the Republic the required legal reserves. The Mission in this report has elsewhere suggested certain penalties to be imposed in the event that a reserve deficiency occurs. The Mission does not believe that it is appropriate to authorize seizure of banking properties merely because of the existence of a temporary reserve deficiency.

Title VII, Chapter 2, Article 7.

This article provides, among other things, that series B bonds shall be negotiable at a discount not in excess of 1 percent. Although the Mission has indicated an opinion that such securities should probably be salable at a discount no greater than this, it believes that it is probably unwise to place in the law a prohibition against a discount in excess of 1 percent.

The Mission notes the existence of a provision for issuance of series C bonds with a maturity between 90 and 180 days and with an interest rate not in excess of 4 percent. In a letter to the Finance Minister subsequent to the Mission's Second Report, the Mission suggested the possibility of using Treasury interest-bearing obligations with serial maturities not in excess of 5 years. The Mission is not hereby recommending the inclusion in Article 7 of the recommendation contained in this letter. In the absence of knowledge as to whether the provision of Article 7 relating to series C bonds was prepared before or after receipt of the Mission's letter, the Mission wishes merely to call attention to the difference between the provisions in the Draft Law under review and the recommendations.

The Mission also wishes to call to the attention of the Cuban officials that the Draft Law under review contains no provision for the issuance of Government obligations which would permit the Central Bank

to dispose of its silver at bullion value in accordance with the recommendations made in the Second Report.

Title VII, Chapter 2, Article 10.

This article establishes certain taxes for the purpose of financing the office of the Inspector General of Private Banking. The Mission wishes to observe that in its opinion these taxes are considerably in excess of what it would regard as reasonable. It believes, for example, that a tax of 5 to 10 cents per check on private accounts is excessive and would constitute a serious deterrent to the use of checking facilities.

NOT TO BE RE-TRANSMITTED

COPY NO. 13

BRITISH MOST SECRET
U.S. SECRET

OPTEL No. 12

Information received up to 7 A.M., 11th January, 1943.

1. NAVAL

One of H.M. Fleet minesweepers accompanying convoy to North RUSSIA is presumed lost by enemy action on 31st December.

MEDITERRANEAN. 8th/9th. Two of H.M. Destroyers sank 3 schooners off east coast of TUNISIA. One of H.M. Trawlers has been lost with all hands. Reference OPTEL No. 11 7 out of 9 tankers in convoy TRINIDAD to MEDITERRANEAN have been sunk.

2. MILITARY

LIBYA. 7th. In the FEZZAN Fighting French Forces captured MEURZOUK.

TUNIS. Strong enemy raids on the French positions at BOU ARADA on 7th/8th and TICHON on 8th/9th were repulsed.

BURMA. On the ARAKAN Coast our troops have now reached a position 10 miles north of AKYAB Island.

3. AIR OPERATIONS

WESTERN FRONT. During nights 8th/9th and 9th/10th 370 sea mines were laid. 9th/10th [illegible] 57 tons H.E. and 57 I.B. Weather cloudless, good visibility, only slight ground haze. Bombs seen to burst in target area concentrated fires developing and already large when aircraft left, many other scattered fires. Intense anti-aircraft and numerous searchlights. 10th. Out of 10 enemy aircraft which crossed English Coast. Typhoons destroyed 1 and damaged another.

LIBYA. 8th/9th. Wellingtons bombed MASURATA and machine gunned a landing ground and M.T. in that area. 9th. Kittyhawks made 2 successful bombing attacks on M.T. in the WADI ZEM ZEM. At night Wellingtons attacked road junctions east of TRIPOLI and north east of CASTLE BONITO.

BURMA. 9th. Blenheims bombed RATHEDAUNG and Hurricanes attacked villages and communications at an area about 110 miles south of MANDALAY.

JAN 12 1943

The Honorable,

The Secretary of the Treasury.

Dear Mr. Secretary:

I am advising General Eisenhower of Treasury personnel now in the Armed Forces who should be considered for the special work in North Africa, as suggested in your letter of January 7.

As the Naval and Coast Guard personnel listed in your letter are not under my jurisdiction, it will be necessary to obtain approval of the Secretary of the Navy for their release for assignment to General Eisenhower, however, the whole affair will be coordinated by the War Department.

Sincerely yours,

(Sgd.) HENRY L. STIMSON

Secretary of War.

OFFICE OF THE DIRECTOR

TREASURY DEPARTMENT

PROCUREMENT DIVISION

WASHINGTON

January 12, 1943

MEMORANDUM TO THE SECRETARY:

There is submitted herewith the operating report of lend-lease purchases for the week ended January 9, 1943.

As the result of negotiations with the War Department, we now have assigned to us the space specified below at the depots named, which space is used for the storage of lend-lease goods.

Depot	Covered Storage	Ground Storage
Belle Meade Quartermaster Depot Belle Meade, New Jersey	200,000 Sq. Ft.	
Elmira Holding & Reconsignment Pt. Horseheads, New York	500,000 Sq. Ft.	1,000,000 Sq. Ft.
New Cumberland Quartermaster Depot New Cumberland, Pennsylvania	400,000 Sq. Ft.	
Montgomery Holding & Recon. Pt. Montgomery, Alabama	200,000 Sq. Ft.	
Sierra Ordnance Depot Herlong, California	200,000 Sq. Ft.	
Terre Haute Ordnance Depot Terre Haute, Indiana	500,000 Sq. Ft.	500,000 Sq. Ft.
Total	2,000,000 Sq. Ft.	1,500,000 Sq. Ft.

In addition, we have the use of available space at all other holding and reconsignment points operated by the War Department, such as Voorheesville, N. Y., Marietta, Pa., Richmond, Va., Shreveport, La., West Yermo, Calif., Pasco, Wash.

We have trained and placed at the various depots representatives to handle our business, and the difficulty by reason of the Army's inability to supply sufficient labor, equipment, and trackage facilities at certain of the points is being readily overcome.

Clifton E. Mack
Director of Procurement

LEND-LEASE
TREASURY DEPARTMENT, PROCUREMENT DIVISION
STATEMENT OF ALLOCATIONS, OBLIGATIONS (PURCHASES) AND
DELIVERIES TO FOREIGN GOVERNMENTS AT U. S. PORTS
AS OF JANUARY 9, 1943
(In Millions of Dollars)

	Total	U. K.	Russia	China	Administrative Expenses	Miscellaneous & Undistributed
Allocations	$2724.5 (2722.6)	$1302.8 (1303.4)	$867.9 (858.9)	$58.3 (58.3)	$3.7 (3.7)	$491.8 (498.5)
Purchase Authorizations (Requisitions)	$2163.4 (2146.8)	$1249.4 (1234.5)	$844.9 (843.5)	$41.2 (41.2)	- -	$ 27.9 (27.6)
Requisitions Cleared for Purchase	$2030.0 (1998.4)	$1191.4 (1167.3)	$770.6 (763.3)	$41.1 (41.1)	- -	$ 26.9 (26.7)
Obligations (Purchases)	$1907.0 (1875.3)	$1110.6 (1100.7)	$728.6 (717.3)	$41.1 (41.1)	$3.5 (3.3)	$ 23.2 (22.9)
Deliveries to Foreign Governments at U. S. Ports*	$ 817.8 (804.4)	$ 644.7 (634.9)	$148.1 (142.7)	$20.3 (20.3)	- -	$ 6.7 (6.5)

*Deliveries to foreign governments at U. S. Ports do not include the tonnage that is either in storage, "in-transit" storage, or in the port area for which actual receipts have not been received from the foreign governments.

Note: Figures in parentheses are those shown on report of January 2, 1943.

EXPLANATION OF DECREASES

The reduction of $600,000 in allocations to the United Kingdom is the result of the withdrawal of one requisition.

MEMORANDUM FOR THE FILES

Presentation of British Material
to be Submitted to Congressional Committee

Mr. Playfair telephoned on January 12, 1943, 5:30 P.M. to say that they had gone over our draft statements for presentation to Congress and that they had only a few comments to make. First on the asset table he noticed we inserted the statement on Belgium gold. They would prefer not to include it but they did not feel strongly. They thought it was really a question of presentation and one for us to decide.

Secondly, on the expenditure table, they preferred to omit the reference to gold expenditures and receipts and to speak of dollar expenditures only. I said that we had no strong feelings on the matter and would probably act in accordance with their preference.

Thirdly, he noted that we had included anticipated receipts from expenditures of the U.S. Armed Forces in the Sterling Area. As the item is well hidden, our treatment of it is acceptable to them.

Fourthly, on the table giving the comparison of assets held at various dates, he wanted to call attention to the fact that the figure for gold as of August 31, 1941 did not include $10 million of scattered gold and that this omission was inconsistent with the figures given for the other dates. I replied that I was aware of the omission and called his attention to the fact that in previous published statements we had continued to use the unrevised figure of gold holdings as of January 1, 1941 which was first made public in January of that year on the ground that it seemed preferable to continue to publish the same figures rather than explain a revision. He agreed.

Fifth, Mr. Playfair said that he would be glad to come over to the Treasury to discuss any of these comments but if we were satisfied with handling the matter by telephone it was agreeable with them. I called his attention to the fact that we would like to discuss the use to be made of the figures. I said we had interpreted Sir Frederick Phillips' letter to mean he understood the figures would not be published. He said that he thought Sir Frederick Phillips would like to handle this matter. I said I would inform Mr. White of his comments and he could expect to hear from us.

On January 13, 1943, 9:37 A.M., Mr. White telephoned Sir Frederick Phillips to raise the question of the use of the data. He stated that the Treasury would have to present the material to Congress if the Committee asked for it but that we would do what we could do to keep the data from being made public. He asked for Sir Frederick Phillips'

Division of Monetary
Research

approval of this policy. Sir Frederick Phillips agreed after emphasizing the British preference that the data not be made public. Mr. White said that we would try to make that clear to the Committee, if the Committee pressed for the material, but the Treasury must feel free to submit the report to the Committee if the latter desires it, and we could not guarantee that they might not include it in their published hearings.

Mr. White transmitted this information to Mr. Bell and informed him that the material had been approved and would be ready shortly for his perusal.

Mr. Playfair called my office shortly after Mr. White had spoken to Sir Frederick Phillips about the use of the British figures to say that they had had a second thought on their presentation and to request that no action be taken until a written communication is received from him.

The communication attached enclosed two alternative set ups for the asset table with explanations for the British preference.

T. M. Kistler

THE BRITISH SUPPLY COUNCIL IN NORTH AMERICA

TELEPHONE REPUBLIC 7880

BOX 680
BENJAMIN FRANKLIN STATION
WASHINGTON, D. C.

January 13, 1943

IMMEDIATE

Dear Miss Kistler,

In view of your statement last night that you might be forced to publish our statements, we have had second thoughts about their presentation. What worries us is the figure of $1066 millions for total "available gold and dollar assets." They are not all available in any real sense, as the notations show. I therefore enclose a revised lay-out in two alternative forms of "Available gold and dollar assets", disclosing exactly the same information, but meeting this point; I would be glad if you would consider it.

If this lay-out is adopted, the table comparing the data with past years could remain unchanged, except that a note should be added to the word "gold" to explain that these figures exclude Belgian gold, if lay-out A is adopted; this note would not be necessary if lay-out B were adopted. Personally, I prefer B, since though it is less logical, it keeps uniformity in the basic figure for gold.

Yours sincerely,

E.W. Playfair

E.W. Playfair

Miss Kistler
U.S. Treasury
Division of Monetary Research
Washington, D.C.

Enc.

A

AVAILABLE GOLD AND DOLLAR ASSETS

1. Gold	793	
Less $105 million of gold borrowed from Belgium, which involves a definite gold liability of like amount	105	
	688	
Less sterling funds held by foreign countries which carry specific rights of conversion into gold amounting to approximately	190	498
2. Official dollar balances	243	
Less the amount of U.S. registered sterling accounts, which carry the right of conversion into dollars on demand. These amounted at November 30, 1942, the latest available date, to	53	190
3. U.S. Securities	135	
Less securities which the British do not regard as readily marketable, estimated at	55	80
Total - available gold and dollar assets		768

B

AVAILABLE GOLD AND DOLLAR ASSETS

1. Gold	688	
Less sterling funds held by foreign countries which carry specific rights of conversion into gold, amounting to approximately	190	498

(In addition, the British hold $105 million of gold borrowed from Belgium. This gold is not included in the British assets since it involves a definite gold liability of like amount)

2.)
) As in lay-out A
3.)

January 12, 1943.

Dear Mr. Currie:

In the absence of the Secretary from his office, I am acknowledging your letter of January 8, and the enclosed copy of the memorandum you prepared for the President on the subject of agricultural production. Your courtesy in sending this to Mr. Morgenthau is much appreciated.

Sincerely yours,

(Signed) H. S. Klotz

H. S. Klotz,
Private Secretary.

Hon. Lauchlin Currie,
Administrative Assistant
to the President,
The White House.

File in Diary

GHF/dbs

Copies - 285 [illegible]
[illegible]
115

THE WHITE HOUSE
WASHINGTON

January 2, 1943.

PERSONAL

Dear Mr. Secretary:

I have been told that you are interested in the outlook for increased agricultural production, so I think you may be interested in the attached memorandum. For your own information, the President has forwarded the memorandum to Secretary Wickard with the suggestion that he see him about it. I feel, therefore, that any additional spontaneous show of interest and concern now would be very well timed.

Sincerely,

Lauchlin Currie

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

COPY

December 30, 1942.

MEMORANDUM FOR THE PRESIDENT:

Re: Increasing Food Production.

I think this is a subject that you may wish to check up on. My own impression is that food goals for 1943 have not been set sufficiently high and that we are not doing enough to ensure that even these goals will be met. I do not think there is any danger of our people going hungry. Failure to increase our food production substantially, however, jeopardizes one of the most important elements in the Administration's war and post-war plans — the feeding of foreign armies and foreign civilian populations — because of the political capital that can be made out of the food shortages at home. I have been told that England has been able to increase its food production by 50 percent with very little additional manpower. Some of the methods that have been mentioned as possible ways to increase agricultural production are as follows:

1. The President might raise the goals for most of the agricultural program just as he earlier raised the goals for the War Production program.

2. The Department of Agriculture might be directed to present a new production program, and, in pursuance of new over-all objectives, directed to present, if necessary, a new budget.

3. A large-scale effort should be instituted immediately to aid the most efficient farmers. This requires removal of all acreage allotments and other restrictions on production. It also requires large scale shift of subsistence farmers into the ranks of farm workers, after preliminary training. Some form of price guarantee is probably necessary.

4. Institute measures to bring into full production approximately one million farm operators who are just below the two million most efficient farmers and who do not now produce enough to keep their labor fully employed. These measures would require a large scale effort to make available to these farmers seed, fertilizer, machinery, livestock and some additional land.

5. Make a more determined effort (a) to reduce acreage devoted to cotton and tobacco, (b) to remove the corn acreage allotment, and (c) feed more wheat to livestock. This latter might be done by instituting a two-price system for wheat. We now have on hand two years' supply of short staple cotton and abundant supplies of tobacco. Acreage devoted to tobacco is actually scheduled to increase next year. In general, every effort should be made to convert benefit and parity payments into a new type of payment to increase war food production.

6. In addition to the training and transportation of subsistence farmers, organize a new land army along the lines of English experience. People from cities and towns, particularly women, could aid not only in meeting the peak seasonal requirements but also the year-round requirements. This requires the complete meshing of the recruiting and replacement services of USES with the food production program.

7. Institute measures to ensure that truck farmers and others on rich soil will convert production from non-essential crops like iceberg lettuce to essential crops.

8. Increase the facilities for processing and drying foods and provide new collection and marketing facilities in small and diversified crop areas. This may necessitate the allocation of additional critical materials by WPB.

9. The successful prosecution of an all out production drive requires action at the county level more responsive to national direction than at present exists. Locally elected committeemen, for example, cannot be expected to exert themselves to move underemployed farm labor out of their counties to areas of labor shortages.

10. In general, a real effort should be made to take advantage of Farm Mobilization Day, January 12, to present a comprehensive program of action rather than merely to exhort farmers to produce more.

In addition, a critical review of army and lend-lease food requirements might reveal unnecessarily large demands.

(Signed) Lauchlin Currie

NOT TO BE RE-TRANSMITTED

COPY NO. 13

BRITISH MOST SECRET
U.S. SECRET

OPTAL No. 13

Information received up to 7 A.M., 12th January, 1943.

1. NAVAL

Yesterday afternoon a Beaufighter reported sighting a battleship, cruiser and destroyer off the SKAW (NORTH DENMARK) steering West. Torpedo-carrying aircraft sent to attack, returned without sighting this force. Weather conditions were bad. A convoy of 4 ships and a tanker arrived at MALTA from ALEXANDRIA yesterday. One of H.M. Submarines off the East Coast of SARDINIA has torpedoed a 6,000 ton ship which subsequently ran aground.

2. MILITARY

LIBYA. 8th. Fighting French forces from CHAD occupied SEBHA 80 miles north of MOURSOUK. 9th. 11 Italian Officers and 99 other ranks fleeing from MOURSOUK surrendered to a single aircraft.

RUSSIA. The capture by the Russians of the towns and railway-stations of GEORGIEVISK, MINERALYNE-VODY, PYATIGORSK and BUDENOVSK together with other towns in this area represents a considerable advance on a wide front north-westwards from the TEREK Sector.

3. AIR OPERATIONS

WESTERN FRONT. 11th. 5 enemy aircraft crossed the East Coast. Naval anti-aircraft fire destroyed one and possibly another. 11th/12th. 85 aircraft sent out-ESSEN 76 (1 missing) Intruders 7, anti-shipping 2. Preliminary reports state that 49 aircraft bombed ESSEN through heavy cloud which prevented observation.

FRENCH NORTH AFRICA. 10th. Escorted U.S. Bombers scored many hits [illegible] and others attacked a camp 35 miles further southwest. TUNIS and LA GOULETTE were bombed by Liberators from CYRENAICA. One U.S. Warhawk (P 40F) bombed a hotel at KAIROUAN used as a German headquarters scoring a direct hit.

LIBYA. Enemy M.T. 100 miles south of MISURATA was machine gunned by Hurricanes on 9th/10th and successfully bombed by escorted Kittyhawks next day.