

October 31, 1946

MEMORANDUM for the Board of Directors

Re: Credits to China for the Hankow-Canton-Kowloon
Railway and Yellow River Bridge

The attached letter of October 29 to the Chairman from Mr. Clayton recommends that the Bank advise the Chinese that it is prepared to consider these projects at this time because of their special character. This recommendation is based on General Marshall's telegram No. 1548, of September 27, 1946, stating that these are urgent projects and cannot be confused with general restrictions on aid to China at this time.

On September 5, 1946 the Bank replied to Dr. S. C. Wang's request, under date of September 3, to the effect that it could not now consider these two railroad projects because of the existing situation in China. The Bank's attitude on recent requests has been determined in conformity with the following paragraph from the President's statement of December 16, 1945 on policy toward China:

"As China moves toward peace and unity along the lines described above, the United States would be prepared to assist the National Government in every reasonable way to rehabilitate the country, improve the agrarian and industrial economy, and establish a military organization capable of discharging China's national and international responsibilities for the maintenance of peace and order. In furtherance of such assistance, it would be prepared to give favorable consideration to Chinese requests for credits and loans under reasonable conditions for projects which would contribute toward the development of a healthy economy throughout China and healthy trade relations between China and the United States."

It is not within the Bank's competence to determine when the conditions indicated by the President have been met and General Marshall has not yet indicated that they have been met.

There is now no credit open on the Bank's books from which these projects could be financed. As indicated above, the Bank has resisted various apparent attempts to open the major credit of \$500,000,000 earmarked last April. Any credit made available to China at this time would be either an addition to the credits potentially available to that country at a time when the Bank's resources are already largely committed, or it would signify the opening of the major credit to the many projects which the Chinese advance from time to time. In either case it would be interpreted by all parties in China as further support of the existing regime.

The case for giving these requested credits A-1 priority in the economic rehabilitation of China has by no means been established. In conferences in this office Dr. Wang has been reluctant to indicate priorities, which he remarked would be a simple problem if the Bank were more generous in its assistance to China. He has indicated, however, that the Morrison-Knudsen Co. projects are given high rank. Although all are agreed that the restoration of China's railways should have very high priority, it seems probable that at the present time the rehabilitation of coal mines is equally important from an economic point of view. Electric power has to be rationed in Shanghai for want of coal supply, and fuel for heating purposes is available only in very limited quantity. It is perhaps pertinent to mention in passing that coal mines whose output could relieve the existing shortage are at least as accessible in a military or political sense as the Yellow River Bridge.

It is to be noted also that the Hankow-Canton-Kowloon Railway is actually in operation, although it is by no means in first-class condition.

Reference may be made to an article on this railway in last Sunday's New York Herald-Tribune. Furthermore, the Bank on February 20 last authorized a credit of \$16,650,000 for railway repair materials, of which some \$7,000,000 have not yet been availed of. UNRRA has programmed \$50,000,000 worth of railway and bridge material and rolling stock for China, of which approximately one-quarter has been shipped. The remainder is to be delivered by June 1947, although uncertainty is expressed with regard to delivery of 50 locomotives, or about 10% of the total value. Colonel Tudor, of the Morrison-Knudsen firm, contemplated use of this UNRRA material to the extent suitable and corresponding reduction of estimated requirements for the Canton Railway.

Although, pursuant to the Bank's statute and policy, the Chinese representatives have repeatedly been asked to provide information relative to China's ability to repay credits advanced, no information has been forthcoming from them. Without attempting at this time to present a comprehensive estimate of China's foreign currency obligations, it may be noted that China's pre-war private debt as of June 1945 was dependably estimated at \$335 million after taking account of the reduced value of sterling, the cancellation of the Boxer indemnities and of debts to the Axis Governments, and the assumption by those Governments of their nationals' claims against China. (The effect of these adjustments is to reduce the pre-war U.S. dollar value of the debt by about \$200 million). This figure of \$335 million included \$30 million for capital arrears (which appears to me to be an under-statement) but apparently makes no allowance for arrears of interest accumulated since the moratorium of 1939. To this amount should be added war-time commodity credits granted by Britain and Russia, which the Ministry of Finance stated

at nearly \$200 million as at the end of 1944, some \$73 million owing to the Export-Import Bank (including recent payments and guarantees), and approximately \$50 million for lend-lease pipeline. China's foreign debt thus appears to be of the order of \$300 million, service on which implies a serious burden on her balance of payments. This figure is exclusive of about \$100 million of credits (including approximately \$60 million from Canada) available but unused and, of course, of credits only provisionally arranged (including the credit sale of ships by the Maritime Commission). It is also exclusive of China's internal debt in foreign currency, which was estimated last year at more than \$400 million. With respect to these internal obligations, however, it is to be noted that they have been largely used as security for loans from Chinese banks and may never become obligations requiring settlement in foreign currency.

As bearing on China's foreign exchange resources it is to be noted that the Central Bank of China lost foreign exchange and gold amounting to nearly \$250 million during the seven months following establishment of the official rate of CN\$ 2020 to US\$ 1, and that the rate of depletion has been increasing of late.

In view of the foregoing it may seriously be questioned whether China's financial position and trade prospects within the next few years, in all of which the political situation plays an important part, are such as to justify this Bank in making further substantial credits available, and whether the extension of such credits would be in the best interests of China. In this view I suggest that a reply be sent Mr. Clayton in the sense of the attached draft.

Oliver C. Lockhart

Attachments:

Copy of letter from Mr. Clayton
Draft of Reply to Mr. Clayton