FURTHER DETAILS ON THE BANK FOR RECONSTRUCTION AND DEVELOPMENT

The Treasury has recently made available to us a 77-page mimeographed document, dated February 24, entitled "Questions and Answers on the Bank for Reconstruction and Development." This document, which answers 22 questions presumably raised by British and other foreign monetary experts, is valuable chiefly for its detailed elaboration of various provisions in the plan, but it also adds some new information on how the bank would be organized and operate, the principles it would follow, and the benefits which it would confer. This memorandum will briefly outline some of the more salient features of the document.

1. Scope of Operations:

The document makes it much clearer than does the draft of the plan that the primary objective of the bank will be to act merely as a guarantor of approved private foreign loans handled through the regular investment channels, and that the bank's direct lending and participation in private loans will be essentially secondary aspects of its activities. Such guarantees will be necessary, if an adequate flow of private capital into worthwhile foreign investment projects is to be stimulated, in view of the general disrepute into which foreign loans have fallen and the fact that the public in many cases may not be familiar with the position of the borrower and thus the quality of the security.[1] The bank will participate in a loan only when and to the extent that its participation is required to place an approved issue in the private capital market, and it will likewise make direct loans only when the market cannot supply funds on reasonable terms even with the bank's guarantee. Such

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1/The document points out that the guarantee given by the bank need not be the same for all loans, but will depend upon the circumstances of the case. In some instances the bank will guarantee in full both principal and interest while in others it will guarantee principal or interest, or any part of these payments.

direct loan and participation operations are likely to be most important in times of depression and in the early postwar years. In both of these cases the securities acquired by the bank will be disposed of on capital markets at the earliest opportunity, perhaps with the bank's guarantee, since the bank is not primarily interested in having its own funds tied up in holdings of securities.

2. Capital Subscriptions:

Since the bank's direct loan and participation operations will be only a secondary aspect of its activities, the working capital requirements of the bank will be relatively small and the specified initial subscriptions of 2 billion dollars (amounting to 20 per cent of the authorized capital of 10 billion dollars) should, according to the document, be sufficient to enable the bank to meet its requirements for direct loans and participations. (Should additional working capital be required, however, the bank may, according to the provisions of the plan, call up a further part of the total subscriptions, issue its own securities, or borrow from financial institutions in member countries.) The capital that is not called up, comprising the bulk of the aggregate capital, will be considered as a surety fund behind the bank's obligations as a guarantor (or issuer) of securities. The existence of this surety fund should make it possible for the bank to act as a guarantor for loans amounting to two or three times the bank's aggregate capital without impairing the high quality of its guarantee. The figure of 10 billion dollars should thus by no means be considered the limit to the amount of foreign investment which may theoretically be made possible by the operations of the bank.

3. Subscription Formula:

In the draft of the plan it is specified that each member's contribution or subscription to the fund shall be determined by an agreed-upon formula which shall take into account "such relevant data as the national income and the international trade of the member country." The present document elaborates upon this statement somewhat by pointing out that in testing various formulae it was found that a fairly satisfactory apportionment of subscriptions could be secured by requiring each member to subscribe an amount equal to 4 per cent of its estimated national income in 1940 and 6 per cent of its average annual foreign trade through 1934-38. (On the basis of this formula the American contribution would approximately equal 3.3 billion dollars, although this figure is not mentioned in the document.) The document points out, however, that it might be desirable to adjust subscriptions upwards or downwards by as much as 20 per cent of the amount determined by the formula when such an adjustment is believed equitable. It is further pointed out that national income and foreign trade were chosen as the two elements in the formula since they best reflect, respectively, a country's ability to pay and its potential benefits to be derived from the scheme.

4. Relations between the Bank and the International Stabilization Fund:

The document points out that the Bank for Reconstruction and Development and the International Stabilization Fund (proposed under the White plan) will each have distinct functions of its own and that, while the existence of one is not essential to the other, each will enhance the effectiveness of the other. In carrying out their separate activities the two organizations will cooperate and consult on matters of joint interest, and it is expected that all United and Associated Nations will join both organizations. Although it is true that conceptually there is a sharp distinction between the operations of an international currency stabilization organization and a long-term investment bank, in actual practice it may often be difficult to distinguish requests for foreign exchange which are required to meet balance of payments deficits and those which are required for reconstruction and developmental projects. This difficulty will be greatest during the so-called transition period. It is to be regretted that the document does not elaborate more fully upon the relations between the two organizations and the manner in which their respective operations might be better integrated.

5. The Bank and Postwar Relief and Rehabilitation:

It is specifically emphasized in the document that the bank will not participate directly in postwar relief operations, but will leave the task to UNRRA and other related agencies. It is properly pointed out, however, that to the degree that the bank assists in reconstruction of plant and equipment (which fall within its field), relief requirements will be reduced and the duration of these requirements shortened.

6. Provision against Exchange Losses:

In the draft of the plan it is specified that local currency holdings of the bank are to be guaranteed against any depreciation of their value in terms of gold, though no details are given. It is now made clear that the method of protection will be the same as that suggested in the White plan. If a member reduces the value of its currency in terms of gold, it will be required to compensate the bank for the loss by delivering an additional amount of its local currency such that the gold value of the bank's holdings of that currency after depreciation will be the same as before. It is not specified, however, whether, as under the White plan, this procedure will be reversed in case a member currency appreciates.

7. Gold Holdings:

One of the most interesting answers in the document is that which gives the reasons why the plan makes provision for assuring as large a fraction as possible of the bank's liquid assets in the form of gold.2/ Four reasons are given.

a. Holdings of gold will enable the bank to acquire currencies which are demanded by borrowers and of which the bank happens to have an insufficient supply on hand. In this way prospective borrowers will not be forced to buy goods in the countries whose currencies the bank happens to have available, and the bank will thus be able to implement its commitment, under the provision of the plan, to "impose no condition upon a loan as to the particular member country in which the proceeds of the loan must be spent."

b. The bank will need gold occasionally to compensate capital goods supplying countries for their losses of foreign exchange resulting indirectly from the bank's loans. For example, China might acquire a loan from the bank in sterling in order to buy equipment in Britain. Britain, in order to produce the equipment, might have to increase its purchases of needed raw materials in, say, Chile, and some pressure would thereby be put on the British balance of payments. According to the plan, the bank, at Britain's request, has to repurchase from Britain with gold (or needed foreign exchange) part of the sterling lent to China, thereby compensating Britain for the gold and foreign exchange it lost in connection with its purchases in Chile.

c. The bank must be in a position to meet its obligations promptly regardless of the currencies in which they fall due. Holdings of gold are the best assurance that the bank will always be able to obtain a sufficient supply

2/The relevant provisions are: (1) Each member must provide the bank with not more than 20 per cent of its initial and subsequent subscriptions in the form of gold; (2) member countries must repurchase with gold their local currency held by the bank to the extent of not more than 2 per cent annually of their paid subscription, although no country is required to use more than one half of the increase in its official gold holdings for this purpose; (3) payment of interest and principal on loans participated in or made by the bank shall be made in gold (or acceptable currencies).

of each currency to meet its obligations. (The bank has a contingent liability as a guarantor of loans made to members through private investment channels and a direct liability for the securities it has issued.)

d. The bank may also need gold occasionally to meet balance of payments pressure on a borrowing country resulting from the indirect effects of its borrowings, i.e., from the increased demand for foreign exchange (over and above that provided in connection with the loan project itself) due to the higher domestic level of national income resulting from the initiation of the project. For example, if China borrows abroad with the bank's guarantee in order to purchase equipment in connection with a specific project, the resulting higher level of income in China will increase the demand for imports in general. The bank, in order to meet this pressure on the Chinese balance of payments, is empowered to provide a sum in gold (or needed foreign exchange) equivalent to part of the loan itself.

8. Some Advantages of the Bank:

Several of the answers in the document are concerned with listing various advantages which the bank will have in the field of international investment. The following are suggested: (1) the bank will have a wholesome effect upon the volume and quality of international investment by restoring the confidence of investors in foreign securities; (2) the standards established by the bank for its own lending activities will over a period of time have a beneficial effect on the attitude of private investors; (3) the emphasis placed by the bank on the importance of reasonable rate and term provisions for foreign loans should contribute to greater security on such loans; (4) the bank, by having an over-all picture of the loans contracted by a borrowing country, will be able to discourage excessive extensions of credit to individual countries; (5) the bank may be able to coordinate its lending policies so as to prevent large fluctuations in international investment and may be able to regulate the flow of capital for anti-cyclical purposes; (6) the bank will have more facilities available than have private investors for the investigation of proposed loan projects; (7) since long-term investment affects every aspect of international economic life, it should be supervised and directed by an international organization.

9. Relations of the Bank and Member Countries:

Throughout the document there are repeated references to the fact that the provisions of the plan are framed in such a way that the operations of the bank will have as little effect as possible upon the security and money markets of member countries and upon their foreign exchange positions. It is also emphasized that a member country has the power at all times by simple veto of its representatives to prevent the bank from guaranteeing, participating in, or making any loans in its currency without its consent. It is obvious, therefore, that Treasury experts are anxious to assure potential member countries that, whereas the benefits of the bank will be manifold, its interference in domestic policies and its effect upon domestic economies will be as small as possible.

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