

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

To Chairman Eccles

Date March 11, 1942

From Mr. Carpenter

Subject: _____

At the meeting of the Board yesterday it was agreed unanimously that, inasmuch as you most probably would be the representative of the Board who would testify in the event of hearings on the proposed Inter-American Bank, you should review the attached draft of statement with Mr. Gardner, and, when approved by you, the statement should be sent to Mr. Berle, Assistant Secretary of State, for his comments and suggestions, following which the statement would be placed in final form.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

To Chairman Eccles
From Walter R. Gardner

Date February 17, 1942
Subject: Inter-American Bank Statement
for Mr. Berle's Comments

WRC

There is attached a revised statement for use if a member of the Federal Reserve Board is asked to testify on the Inter-American Bank.

Supplementary memoranda dealing with questions such as the Congressional Committee might raise are in course of preparation. They give (1) a non-technical summary of the Convention, Charter, and By-laws of the Inter-American Bank, (2) a statement of the capital of the Bank and the amount of the American subscription on various assumptions, (3) a discussion of the powers and present field of operations of the Export-Import Bank and its probable relation to the Inter-American Bank; (4) a comparison of the Inter-American Bank and the Bank for International Settlements. There may also be a brief note on the question of whether the Federal Reserve Banks might properly lend to the Inter-American Bank amounts larger than the capital and surplus of the Reserve Banks themselves.

It was my understanding that, if the Board found the revised statement acceptable, it intended to submit it to Mr. Berle for his comments. If the Board members wish to return the various copies of the statement to me indicating their acceptance or suggested changes, a final copy can be made up for this purpose.

Attachment.

I N T E R - A M E R I C A N B A N K

(Statement for use if a member of the
Federal Reserve Board is asked to testify)

By the terms of the Convention for the establishment of an Inter-American Bank, the Government agreed to grant to the Bank a charter substantially in accordance with the proposed Charter annexed to the Convention. The Convention, Charter, and By-laws of the Bank have been approved by the Inter-American Financial and Economic Advisory Committee, composed of representatives of the twenty-one American Republics, and the Convention has been signed on behalf of the Governments of nine countries, including the United States. A number of other Latin American countries are understood to be ready to sign the Convention once ratification by the United States has been completed. Any substantial changes in the Convention or its attached Charter and By-laws would require this Government to negotiate again with all the other Governments concerned in order to obtain their assent to the changes and their signatures to the revised documents. Unless, therefore, there are strong reasons to the contrary, it is to be hoped that the Convention may be ratified and the Charter granted in substantially the form in which they were submitted to the Congress.

The need for an Inter-American Bank

The Inter-American Bank plan was developed at a time when the second World War was under way. It was designed as a contribution to the financial stability of this Hemisphere in the face of the grave disturbances to trade which had occurred and the further unsettlement of economies that might be anticipated. The recent spread of war to the United States and a large number of Latin American countries has only accentuated the need for institutions that pool the economic power of the Americas and bring it to bear where it can most effectively serve the common interest.

The Bank will have power to deal broadly with central banks in financing the flow of trade and maintaining active and stable exchange markets. Its loans and investments in various countries cannot be blocked. It will always be free to transfer repayments in local currency of the borrowing country at the most favorable rate of exchange available to anyone. This freedom, assured by formal provisions in the Convention itself, will enable the Bank to engage in currency stabilization operations without fear of sudden imposition of exchange controls. It will preserve a nucleus of free exchange transactions that may be expanded as Latin American countries develop a stronger balance of international payments.

The Bank will also finance long-term developments in the member countries. If this financing is wisely handled, it will tend to correct the unbalanced international position from which so many countries of this Hemisphere have suffered. It can promote local industries that will diminish the dependence of these countries upon imports and it can help to open up new areas and develop new products that will find a market abroad, particularly in the United States. Both transportation facilities and means of communication may be powerful agents toward this end. Investments which lessen the need for foreign goods and expand the exporting capacity of a country tend to provide their own means of repayment. If, however, the favorable balance of trade which they tend to create is slow in developing, the Inter-American Bank, viewing the problem as a whole and enjoying immunity from exchange control, can take payment in local currencies and make transfers into dollars later as there is opportunity to do so without disturbing the exchanges. There will be no need to force a crisis upon the entire economy of a debtor country by insistence on payment in dollars during a weak phase of the debtor's international trade.

In the past, private creditors have hardly been in position to take so broad a view. Each creditor group had to look after its own particular loan and strive to maintain such advantages as its contract possessed. It could not work with the economy of the country as a whole. Nor could it, in the face of an adverse balance of payments, finance corrective measures and wait for them to work out. The Latin American situation developed so many difficulties in the 1930's that private United States financing was drastically curtailed.

The Export-Import Bank established in 1934 was designed in some measure to fill the hole left by the shrinkage in private financing of Latin American trade and enterprise. It has done a good job. But both the private loans of the 1920's and the more recent loans of the Export-Import Bank have had the common characteristic that they put the United States in the position of sole creditor over against a group of debtor countries. There has been no institution in the field equipped to act on the responsibility of the American countries as a group in extending credit to any member of the group. The Inter-American Bank fills this need.

All the countries which join the Bank will have a financial stake in it. They must subscribe to its capital. Furthermore, as time passes they will find that citizens or agencies of their countries have made deposits in the Bank or bought its debentures. All member countries, in varying degrees, will be risking their own funds in the operations of

the Bank and all will be represented on the Board of Directors. When one country asks for a loan, its request will be passed upon not solely by the United States but by other American nations as well. Its financial record and credit status and its proposed use of the funds will be appraised by a group of its peers. And when the time for collection comes, it will not be any one country insisting on payment, but the whole group of member countries. It will make for a better balanced and more healthy situation. And the cooperative consideration of Latin American credit needs should prove most helpful in getting better coordination of Latin American investment programs and a better administration of them. If Latin Americans in due course develop a willingness to deposit with the Bank funds that otherwise they might have sent abroad and if they buy the Bank's debentures instead of foreign securities or local real estate, it will be possible for the Bank to channel more Latin American capital into productive enterprise of a diversified character at home.

These are some of the constructive possibilities of the proposed institution that would render it useful even in time of peace. Under the critical conditions of war its significance may at any time become enormously greater than these possibilities may suggest. Should financial structures start to collapse in any part of Latin America, the need for a powerful, international institution, the disinterestedness of which cannot be questioned, to step in and stabilize the situation may be of the most urgent character.

Management of the Bank

The Bank has broad powers. It is essential to give the Bank such powers if it is to be in position to do an effective job. From the United States' standpoint the chief mechanical safeguards are that the Bank will have the credit of a Government or a central bank, or other acceptable banking institution, behind its loans and investments; that these will be free of exchange control; and in particular that the United States director will have a veto power on the major operations of the Bank if the United States buys a sufficient number of shares, as is contemplated. None of these, however, will of themselves insure an institution capable of doing a constructive job. From this standpoint it is of the utmost importance that the Bank should have experienced management with continuity of policy. The central banks of the various countries appear to be the natural instrumentalities for the various Governments to use for this purpose. They are the banking arms of their Governments, they serve the public interest, they have experience and continuity. In few countries is there any agency so well qualified as the central banking authority to appoint and advise with the director and act as guardian of the interests of both the Bank and the country. If this is generally recognized and the Governments concerned are encouraged to act through their central banks, the chances of obtaining able management for the Inter-American Bank will be materially increased.

Relation of the Federal Reserve System to the Inter-American Bank

In view of its established powers and functions in the realm of international and foreign banking, the Federal Reserve System is the appropriate agency for the Inter-American Bank to deal with in regular banking transactions in this country. Therefore it is important that the System be given broad powers to deal with the Inter-American Bank, as contemplated in the proposed enabling legislation. The exercise of these powers by the Federal Reserve Banks would be only with the consent of the Board of Governors of the Federal Reserve System and subject to such regulations and limitations as the Board might prescribe.

It is probable that the principal business which the Inter-American Bank will transact with the System will be in the short-term credit field. Presumably, the Inter-American Bank will maintain reciprocal banking accounts with the Federal Reserve Banks through which will flow exchange transactions and rediscounting operations. Under the proposed enabling legislation, however, the Federal Reserve Banks, with the consent of the Board of Governors, can go further and invest in debentures or other obligations of the Inter-American Bank if this seems advisable in the light of conditions existing at the time. The credit facilities which the System will be in position to offer the Inter-American Bank will be varied and comprehensive.

There is no danger that the Inter-American Bank will tend to displace the Federal Reserve System or the Latin American central banks in their own markets. On the contrary, it will assist them. It will facilitate the flow of funds from market to market. In doing so it will be protected by its privileged position on the exchanges; but it cannot exercise the primary central bank powers. It will not have authority to issue notes or to control commercial bank reserves. While dealing directly with central banks throughout the Hemisphere it cannot, therefore, invade their fields in their respective countries.

The Inter-American Bank Committee

The proposed bill creates a Committee to govern the relations of the United States with the Bank. It is composed of the Secretary of State, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the Federal Loan Administrator. This arrangement quite properly recognizes the significance that will attach to the Inter-American Bank in our foreign relations in addition to its varied financial aspects.

The United States director, whom this Committee of four will appoint and who will report back to it, will have a veto power over major operations of the Bank requiring a four-fifths majority vote if the United States buys sufficient stock. To obtain more than one-fifth of the vote would require at most the purchase of 228 shares, an investment of less than 23 million dollars. At the outset 70 or 80 shares -- costing 7 or 8 million dollars -- would be sufficient. Furthermore, most of the Bank's activities in a particular country can be prevented, if they are considered undesirable, by the so-called "timely objection" of that country's director. In addition to these specific controls there is a general provision requiring that "the operations of the Bank shall at all times be conducted in conformity with the laws of the territory where the Bank is acting and, so far as possible, be conducted in conformity with the policies of the participating government directly concerned."

These provisions appear to offer adequate assurance that the Bank will not engage in any operations adverse to the United States. The ultimate power with regard to the whole arrangement lies in the hands of Congress, which may at any time create a new procedure for appointing the United States director and establish as immediate a control over him as it considers advisable.

It is to be hoped, however, that these great powers will be exercised with a minimum of dependence on the sheer right to say "no". If the United States must constantly take a negative position, the Bank will prove an embarrassment rather than a source of strength to this country. The best insurance against such an impasse will be an able and disinterested Board of Directors.

February 16, 1942