

THE PROPOSED UNITED NATIONS BANK  
FOR RECONSTRUCTION AND DEVELOPMENT

On October 8 the Treasury made public the main outlines of its plan for a United Nations Bank for Reconstruction and Development. This move, though prematurely precipitated by the release in London of details of the plan a few days earlier, followed hard upon the heels of a series of revisions in the plan, dated September 8, 13, 16, and 24, and October 1, indicating that the Treasury in any case was presumably getting the plan into final shape pending its early public release. The publication of the plan is of particular interest to us at this time in view of the sharp emphasis which Dr. Williams has recently drawn on the distinction between the problems of international financing in the transitional and in the long-run periods, and between short- and long-term credits. This memorandum, which is based upon the revision of October 1, will analyze the structure and powers of the proposed Bank with special reference to its relationship to the International Stabilization Fund and to the post-war foreign investment problem in general. Since the present Treasury draft differs substantially, both in form and content, from the original scheme submitted to Secretary Morgenthau by Dr. White in April 1942 (which was summarized in a memorandum of this Division, dated January 21, 1943), it seems advisable to re-examine the plan in its present form in some detail.

I

It is agreed by all post-war planners that one essential element in a satisfactory post-war pattern of international economic relations must be a large-scale revival of long-term capital movements. Such a revival is necessary, not only to take care of the immediate post-war problem of the

reconstruction of devastated areas,<sup>1/</sup> but more particularly from the longer-run developmental point of view. There are still large undeveloped areas of the world, to mention merely China, Latin America and much of Asia, where such large-scale developmental projects could be undertaken to the benefit not only of the countries concerned--in the form of increased productivity and higher living standards--but to the world as a whole. Resumption of the international flow of long-term capital will not only contribute to a progressive widening of world trade, but will prove an essential adjunct to any successful scheme for long-run international monetary stabilization.

In the past, the large-scale volume of international long-term investment which played so important a role in the opening-up and development of the world economy before 1914 and during the decade of the 20's was almost exclusively undertaken by private investors, both individual and corporate, either in the form of purchases of new or outstanding foreign (governmental or corporate) securities or in the form of direct investments. Governmental foreign long-term lending, with a few exceptions, such as the American government loans to the Allied Powers from 1917-1920, was relatively unimportant, although governments did play an important part in stimulating or deterring private foreign lending. It is now recognized, however, that private long-term foreign investment on a substantial scale cannot be counted on for several years to come, and in the early post-war years will most certainly not be forthcoming in a volume adequate to meet the heavy

---

<sup>1/</sup> I shall not discuss in this memorandum the question of relief and salvage proper in the immediate post-war years. These matters should be handled on a strict gift or lend-lease basis, and do not fall within the range of reconstruction or development loans proper. Such assistance may well be undertaken by the proposed United Nations Relief and Rehabilitation Administration and perhaps by the Office of Lend-Lease Administration.

requirements. There are various reasons for this. The unhappy experience of private foreign investors during the 30's with such factors as large-scale foreign bond defaults, hostility of governments in debtor countries to foreign capital investment, fluctuating exchange rates, exchange control, political uncertainty, etc., is likely to make private foreign investment unattractive for some time. To these deterring factors must be added the great economic and political unsettlement and confusion which will prevail in the early post-war years; this factor alone will undoubtedly make long-term private foreign lending to most countries of the world highly unattractive. Moreover, it will be in those regions most in need of capital where the uncertainty will be greatest, and where consequently private foreign capital will be most unwilling to venture. While these factors will be most detrimental to the international flow of long-term capital through the new issue market, they will also adversely react upon the expansion of foreign direct investments.

It is clear, then, that if long-term lending, both for reconstruction and developmental purposes, is to take place on an adequate scale for some years after the war, it will to some extent have to be undertaken either directly by, or through the auspices of, the governments of the lending countries. There are, however, other reasons why public foreign investment, particularly through an international organization, will be desirable. The record of private foreign lending during the 20's was on the whole a rather shameful one, and its shortcomings should certainly be avoided in the future through governmental control and through its supplementation by direct governmental lending. The major shortcomings were as follows:

(1) Many foreign loans were floated at rates exorbitantly high in relation to the capacity of the borrowing countries to pay, most of the American loans

to the continent of Europe, for example, bearing rates ranging as high as from 6 to 8 per cent. (2) Moreover, much of the lending was reckless and excessive in character, reflecting not only wasteful and unnecessary borrowing on the part of debtor countries and their injudicious application of the loan proceeds, but also high-pressure salesmanship on the part of the underwriting houses and their failure adequately to check the underlying merits of the proposed flotations. (3) The international flow of long-term private capital also showed itself erratic and irregular in character, subject to shifting winds, as is amply illustrated by the drastic and sudden decline in the volume of American long-term loans late in 1928 which played a major part in bringing on and intensifying the world depression. (4) Finally, under the regime of private foreign investment many countries in genuine need of long-term capital were unable to obtain it, except at impossibly high rates, while many necessary socio-economic developmental projects, such as public sanitation, conservation of natural resources, eradication of diseases, etc., not yielding direct economic returns, were unattractive to private foreign investors.

Under an international investment organization owned and controlled by member governments, most of these shortcomings can be eliminated. Such an organization would be guided by much broader considerations than the strict profit and market calculations which motivate the behavior of private foreign investors. As such, it would be in position to extend long-term loans to needy borrowers at rates more closely approximating their ability to pay and would be able to extend loans for projects of a socio-economic character, which bear no direct monetary returns, but which contribute ultimately to a higher productivity and living standard in the borrowing countries and which benefit other countries in more subtle ways. An

international governmental bank, moreover, would be in a position to subject each proposed loan project to a more careful scrutiny, both as to its potential effects on the borrowing country's productivity and on its balance of payments position, than would private underwriting syndicates. Another advantage of such a Bank would be that the erratic fluctuations which have characterized private foreign investment in the past could be largely avoided. The flow of capital, in fact, could be used as an anti-cyclical device rather than as a factor potentially intensifying cycles. In time of depression, for example, such a Bank could launch upon an intensive program of international lending. It would also be in more of a position to concede to a temporary suspension of amortization payments with respect to a debtor country experiencing exchange difficulties than would be the case if the bonds were held by a large number of anonymous and scattered owners. There is, in addition, the consideration that governments, if themselves lenders, may prove more willing to accept the truism that in the long run international debts can be liquidated only in goods and may be willing to adjust their trade policies correspondingly.

There are special reasons why an international governmental lending agency (as contrasted with a purely national one) has distinct advantages. In the past private foreign investment has probably been the major vehicle for imperialist expansion on the part of the leading powers and, by the same token, one of the major sources of international friction and war. (We do not go into the controversial question of whether more commonly it was foreign investors which enlisted governmental political and military aid in the expansion and the protection of their investments, or whether it was governments which played the active role in using private investments as a tool with which to achieve their imperialistic ambitions.) By "denationalizing" foreign investment, i.e., by extending long-term loans through an

impersonal international organization, the dangers of political clashes between debtor and creditor countries, or between creditor countries themselves, would be greatly narrowed. A final advantage of an international organization for long-term lending lies in the pooling of investment resources which it achieves, and in the fact that debtors, by being members of the organization, would probably have a greater incentive to honor their international obligations.

## II

The proposed United Nations Bank for Reconstruction and Development is to be set up in the form of what might be termed an international public corporation, or an R.F.C. on international lines, whose capital stock is to be owned entirely by the participating governments and whose purpose is to serve public, and not private, ends. In brief, the Bank is empowered to make loans directly, or to guarantee or participate in loans granted by private agencies, for purposes of reconstruction and development, of facilitating a smooth transition from war to peace, of raising world productivity and of promoting the growth of international trade.

1. Organization of Bank: The authorized capital of the bank is to be equivalent to \$10 billion, consisting of shares of a par value of \$100,000, making a total of 100,000 shares. Membership is open to countries which are members of the International Stabilization Fund, and such countries may subscribe to a number of shares to be determined by an agreed-upon formula which will take into account such factors as national income and international trade.<sup>2/</sup> It is stated that this formula would make the

---

<sup>2/</sup> It is to be noted that no reference is made to gold and free foreign exchange holdings as a factor in the computation of the quotas as in the case of the International Stabilization Fund.

American contribution about one-third of the total, or \$3.3 billion, (which would compare with an American contribution of roughly \$2 billion under the Stabilization Fund scheme). The liquid assets at the disposal of the Bank may be further increased by the Bank's power to issue, pledge or discount any of its own securities, or obligations taken from its portfolio, and also to borrow from member governments, central banks, stabilization funds, private financial institutions, or international financial agencies.

Subscriptions to shares are to be paid in the form of gold and local currencies. Initially each member is to pay in 20 per cent of its subscription, not more than 20 per cent of which is to be in the form of gold (the proportions of gold and local currencies to be graduated according to a schedule taking into account the adequacy of each member's gold and free foreign exchange holdings). The remainder of each country's subscription is to be paid at such times and in such amounts as the Bank may desire, although not more than 20 per cent of subscriptions may be called in any one year. The proportion of these subsequent payments to be made in gold will be the same as in the case of the initial payments. It is also provided that no calls are to be made unless funds are needed, and if the Bank's resources substantially exceed at any time its prospective needs, part of the subscriptions may be returned to the members on a uniform basis. Another provision is that each member is to repurchase annually, with gold, its local currency held by the Bank, up to 2 per cent of its subscription, but not in excess of one-half of the addition to its official gold holdings during the preceding year. This repurchase requirement may be suspended for any year by a three-fourths vote by the Bank. The Bank's accounts are to be kept in terms of unitas and the unitas value of its local currency assets are to be guaranteed against any depreciation in the value of a

member currency in terms of unitas, presumably according to the method provided for under the International Stabilization Fund scheme.

It is evident from the above that the structure of the United Nations Bank is patterned to a degree on that of the Stabilization Fund in that members are to make contributions in gold and local currency (though not securities), and that these contributions are to be based on quotas determined by a given formula. Although the provision for gold contributions is less strict than under the Stabilization Fund proposal, it would appear that this provision will meet sharp opposition from most of the prospective members. Opposition to the heavy gold contributions in the revised White Plan has already been strongly registered and there can be no doubt that the necessity of making further gold payments to the proposed bank will intensify this opposition unless, of course, the requests for gold contributions are made very small. The repurchase principle would seem to indicate that the Bank's ultimate objective is to have its assets completely in the form of gold without, however, imposing any undue hardships on the member countries, this being evidenced by the qualifications made to the principle.

2. Powers and Operations: The Bank is given a wide range of powers to make, participate in, or guarantee long-term loans to member countries. These loans are to be made either directly to the respective national governments or through these governments to political sub-divisions or corporations.<sup>3/</sup> The Bank's lending powers are subject to a rather wide list of qualifications, which define both the conditions and the terms of the loans. Some of these qualifications are calculated to protect the Bank against loss.

---

<sup>3/</sup> The Bank may also make, participate in, or guarantee loans to international governmental agencies provided that member governments representing one half of the shares of the Bank are participants in these agencies.

For example, payment of interest and principal on any of the loans undertaken by or through the Bank must be fully guaranteed by the national governments to which, or through which, the loans are granted.<sup>4/</sup> More important, a competent committee of the Bank must first make a careful study of each proposed loan project and must satisfy itself, if the loan is to be granted, that it will serve directly or indirectly to raise the productivity of the borrowing country and that the country's budgetary and balance of payments position are favorable to servicing the loan.<sup>5/</sup> This provision has as its object, not merely the protection of the Bank's assets, but also the prevention of unwise or wasteful loans which would subject the borrowing country to repayment difficulties. It is not clear what is meant here by the term productivity, but if this term is interpreted broadly (as it should be) it would seem to leave room open for the Bank to extend loans for socio-economic purposes, although presumably in this case the payment period and conditions of payment would have to be easier than in the case of the loan directed to the creation of a project yielding a direct economic return. This could be effected under the Bank's broad powers to make loans at reasonable rates of interest and with a schedule of repayment appropriate to the character of the project and the balance of payments prospects of the borrowing country. Much flexibility is thus permitted in individual cases. As further protection to the assets of the Bank, it is provided that the Bank must also make arrangements to assure the use of the proceeds of any of its loans for the purposes for which the loan was approved. This clause should serve to prevent the wasteful application of loan proceeds and their

---

<sup>4/</sup> Such a guarantee, however, will not assure payment if the national governments concerned are themselves unable to raise the necessary local currency and/or foreign exchange.

<sup>5/</sup> Presumably this provision should also be read to mean that the loan will eventually make possible increased exports and/or reduced imports, thereby facilitating the servicing and ultimate repayment of the loan.

diversion to such uses as covering budgetary deficits or the adoption of unwise budgetary procedures which characterized much of the lending during the 20's.

It is made amply evident in the preamble and in the text of the plan that the purpose of the proposed Bank is not to supplant private long-term foreign lending, but merely to supplement it. (Analogously, the International Stabilization Fund is so framed as not to disturb ordinary banking operations in the settlement of international balances.) It is specifically provided that the Bank may make, participate in, or guarantee loans only if borrowers are otherwise unable to secure the necessary funds from private sources "under conditions which in the opinion of the Bank are reasonable." Not only will the Bank avoid competing with private agencies when the terms offered by the latter are deemed satisfactory, but, by guaranteeing and participating in loans made by such agencies, the Bank will do much to encourage the international flow of private capital. This is not to imply that the Bank will be an impermanent institution and will be dissolved when an adequate volume of private capital is forthcoming, since there will always be certain projects and certain borrowing countries which will have to be financed through the Bank, but it does indicate that the greater the ultimate resumption of private capital movements, the smaller will be the scale of operations to be undertaken by the Bank.

As noted above, the Bank in making loans will charge reasonable rates of interest and specify a schedule of repayment appropriate to the nature of the project and the balance of payments prospects of the borrowing country. This should remove one of the most glaring shortcomings of the foreign lending of the 20's. In the case of loans in which the Bank participates, however, the rate of interest may be higher than if the loans were

guaranteed by the Bank. In the case of the latter, the Bank is to be compensated for its risk.

In making loans, the Bank will provide the foreign exchange required by the borrower in the currencies of the countries in which the loan proceeds are to be spent (but the provision of such currencies can be made only with the approval of such countries), and these sums will be credited to the borrower's account, upon which drafts can be drawn. On the other hand, it is specifically provided that no condition shall be imposed by the Bank as to the particular member countries in which the proceeds of the loan must be spent, i.e., tied loans are outlawed. What these two apparently contradictory provisions presumably mean is that a prospective borrower may first specify the countries in which he wishes to spend the proceeds of his loan and the Bank will thereupon credit him with the currencies of those countries. It seems to me, however, that freedom of choice on the part of the prospective borrower as to the country in which he may spend his loan proceeds, i.e., whose currency he may acquire, cannot always be adhered to once a currency (or currencies) in demand held by the Bank becomes "scarce." In such a case the Bank will be forced to ration the supply of these currencies, and by the same token will have to inform prospective borrowers that they will have to take the loan proceeds in the form of currencies of which the Bank has a more ample supply, i.e., that they will have to buy the necessary goods and services in specified countries. This, in effect, would amount to a tied loan, since loans will be granted contingent upon the spending of the proceeds in particular countries. In view of the heavy demands which will unquestionably be made upon the Bank for American dollars in order to purchase American goods in connection with specific reconstruction

or development projects in the early postwar years, it may well be that rationing of American dollars will have to commence within a relatively short period after the Bank is set up. As a result, the proposed outlawing of tied loans by the Bank may well become a virtual impossibility.

The purpose of providing, in effect, that a borrowing country may spend the proceeds of its borrowings only upon the goods and services of the country whose currency is provided to it by the Bank is presumably to assure that membership in the Bank will not impose pressure upon the balance of payments of individual countries. This may be an important factor in inducing the adherence to the Bank of certain countries which would be prepared to lend on long-term to other countries only if they had some assurance that such lending, by being directed to their own goods, would not put pressure upon their balances of payments. But this, however, does not cover the whole picture, for even though the borrowing country spends its loan proceeds upon the goods of the country whose currency has been made available, the increased exports from the latter will probably require some increased imports from other countries of materials, etc., used in producing these exports. There will, therefore, in most cases be a tendency for some pressure to be put upon the balance of payments of the countries whose currencies are being made available through the Bank to other countries. This pressure may perhaps be handled through the facilities of the International Stabilization Fund should the country in question be unable to meet it itself.

An important provision is that local currency requirements in connection with any loan project must be financed, at least in the main, locally without recourse to the Bank. That is, no country will presumably be permitted to use foreign exchange proceeds derived from borrowing from

the Bank for conversion into local currency for purchases on goods and services at home. (In exceptional cases where the local part of the project can be financed at home only on very unreasonable terms, the Bank will provide the needed funds out of the local currency of the country held by the Bank, i.e., foreign currencies will not be provided for this purpose.) This provision should do much to prevent unnecessary drains on the Bank's resources, and in particular to prevent the accumulation of foreign debts by countries when they are able to finance part or all of their capital needs domestically.

It must not be overlooked that those loan projects which are partly financed at home will, by creating a demand for local goods and services on the part of the government or corporation undertaking the project, cause an expansion of domestic incomes, not only to an amount equivalent to the funds spent, but to an even greater amount via the familiar multiplier process. Part of this increased income in the hands of residents of the country will tend to be drained away in purchases of foreign goods and services, to a degree depending upon the country's marginal propensity to import. Such a drain will, in the absence of new restrictions upon imported goods, cause pressure upon the country's balance of payments. In granting long-term loans to foreign borrowers in order to enable them to purchase the goods and materials required abroad in connection with the project, the Bank should thus also take into account these secondary demands for imports resulting from the higher level of income within the borrowing country when part of the project is financed at home. It would thus appear that the Bank should extend to each borrower an amount of foreign currency somewhat in excess of the amount which will be immediately required to finance imports in connection with the project itself. On the

other hand, it may be that, if the anticipated secondary demand for imports is not too large, such demand might be handled through the facilities of the International Stabilization Fund (assuming that such an institution is also set up).

The interest and principal on loans participated in or made by the Bank are to be paid in gold, although with the Board's consent payments may be made in currency actually borrowed or in other member currencies. This again indicates that it would seem to be the ultimate objective of the Bank to have its liquid assets completely in the form of gold. In all cases, the amount repaid must be equivalent to the unitas value of the loan and of the contractual interest. Flexibility in loan repayments is made, however, through the provision that in case of an acute exchange stringency the Bank may for a period not exceeding three years accept payment of principal and interest in local currency which the borrower agrees to repurchase over a period of years. Special provisions are also made whereby the Bank may arrange to refund any loan which it has guaranteed, participated in or made. This provision should do much to remove one of the more objectionable features of private foreign lending in the past, namely, the fixed annual amortization and redemption schedules.

An interesting provision in the plan is that a certain degree of "protection" is given to countries in which the loan proceeds are to be spent. As noted above, foreign currencies will be made available to a borrower only with the approval of the countries concerned. Moreover, at the request of a representative of any such country, the Bank may postpone action on a proposed loan for a year, and longer should the representative

so request.<sup>6/</sup> This provision will have the effect of preventing an excessive convergence of demand upon the goods of certain member countries at a time when such convergence might provoke an undesirable inflationary situation in those countries.

It is important to draw attention at this point to a significant difference between the operations of the Treasury's proposed Bank for Reconstruction and its International Stabilization Fund. Unlike the Fund proposal, there is no reference to the amount of long-term loans which any member may be permitted to obtain from the Bank for Reconstruction. The quotas are presumably to be used merely to measure the amount of each member country's subscription, i.e., the degree to which it may have potentially to make its currency, and consequently its resources, available to other member countries. There is theoretically nothing in the plan to prevent any individual country from requesting and obtaining an amount of loans equal to the total liquid assets at the Bank's disposal. It may be that this omission was deliberate in order to give a wider flexibility to the Bank's operations and greater powers to the Bank's directors in deciding upon the volume of loans to be granted to any individual country. It would certainly seem to be advisable, however, particularly from the viewpoint of those members who are likely to have to borrow heavily in the early post-war years, that some broad understanding should be made as to the amount of aid which such countries may potentially receive from the Bank.

Whereas the International Stabilization Fund is on the order of a revolving fund in that members which acquire foreign currencies have to pay for them in their own currencies, under the Bank scheme members which

---

<sup>6/</sup> The borrower may at any time, however, amend the loan application to provide for the expenditure of the loan in a currency or currencies other than that of the country whose representative requested the postponement.

acquire foreign currencies merely turn over securities, or presumably I.O.U.'s. Eventually, of course, as the loans are repaid in the form of gold or local currencies, the Bank's liquid assets will be replenished, and available for further loans. Thus, whereas the local currency assets of the Stabilization Fund are being constantly "turned over" for other local currencies, the Bank's supply of local currencies and gold will be gradually replaced by securities and I.O.U.'s which will not be reconverted into local currencies and gold for some time. This difference, however, is admittedly more apparent than real, for, assuming that in both cases the demand (certainly for some years after the war) will be primarily for American dollars, under both plans the supply of that currency might be exhausted relatively quickly, and the two institutions will soon be filled up with other local currencies not in demand, on the one hand, or with securities and I.O.U.'s, on the other. It has already been noted that as the supply of any one currency in the Bank becomes scarce, the Bank will presumably, in the same fashion as the Fund, have to ration that currency. This rationing will presumably be guided primarily by the principle of making the supply of the scarce currency available to the "neediest" borrowers from the viewpoint of the international situation.

It is to be noted that the loans made by the Bank are all in the nature of fixed-interest-bearing obligations, i.e., they are the counterpart of bonds floated on foreign capital markets and denominated in the currency of the lending country. It has been recognized for some time, however, that international investments should as far as possible be of an equity character in order that the country in which the investments are located may be subjected, not to fixed interest payments, but to payments which will vary with the domestic level of national income, and which will

tend to be adjusted to the balance of payments position of that country. For this reason, direct investments have been looked upon by many students as a more desirable form of international investment than bond flotations or other acquisitions of fixed-interest obligations. To a degree, however, the operations of the Bank, while not involving any direct investments, will achieve some of the flexibility provided by those investments, namely, by carefully examining the potential effects of each proposed loan project upon the productivity, budgetary position, and balance of payments of the borrowing country, by making the rate of interest and the conditions of payment more closely approximate the capacity of the borrowing country to pay than would be the case in the absence of the Bank, and by permitting temporary suspensions, in whole or in part, of debt payments when a borrowing country faces an exchange stringency. Some writers have suggested that an international investment agency should itself undertake some developmental projects, thereby relieving the countries in which such projects are undertaken from a fixed interest <sup>and</sup> amortization schedule. There is nothing in the Treasury's proposed plan, however, which would seem to permit of such operations.

There is one final point which remains to be raised concerning the loans to be extended by the Bank. The Bank will be faced with requests for three broad types of long-term loans: relief, reconstruction, and development. As noted before, relief loans should not be made by the Bank since such loans are not of a productive character in the accepted sense of that term; relief should be handled by such agencies as the United Nations Relief and Rehabilitation Administration and the Office of Lend-Lease Operations and should be made on a straight gift or "lend-lease" basis. The distinction between gifts for reconstruction and for development cannot be easily drawn in all cases, but broadly the former relate to loans for the reconstitution

of capital equipment, factories, houses, etc., damaged, destroyed, or otherwise lost during the war, while development loans would include those whose purpose it is to develop natural resources or to construct plant or equipment not previously in existence. The Bank will have to face the task of allocating its funds between these two broad types of loans, and this allocation will require much careful decision and planning on the part of the Bank's directors. It would appear, however, that priorities should be given primarily to reconstruction loans in the immediate postwar period rather than to loans for long-range developmental purposes. If the Bank should attempt to extend loans freely for both types of purposes, its resources may well be drawn down too rapidly. There is also the question of whether the assets of the Bank, consisting of about \$10 billion, will be sufficient for the purposes for which it was set up, particularly since the demand will be primarily for American dollars of which approximately but \$3.3 billion will be in the Bank's possession. This is a matter which cannot be gone into here.

3. Management of the Bank: The administration of the Bank broadly follows that of the International Stabilization Fund. There is to be a Board of Directors composed of one director and one alternate appointed by each member government. These representatives shall serve for periods of three years. The director or alternate of each member country shall be entitled to cast 1,000 votes, plus one vote for each share of stock held, but no country shall cast more than 25 per cent of the aggregate votes. All decisions, except as otherwise provided, shall require a simple majority. The Board shall select a president of the Bank and one or more vice presidents, to hold office for periods of four years. The Board shall also choose from among its members an executive committee not exceeding nine members

which shall be continuously available at the Bank, and an advisory council of seven members, all experts in foreign investment, which shall advise the Board on general policy.

A member country failing to meet its financial obligations to the Bank may be declared in default and suspended from membership. During its suspension it is to be denied privilege of membership, but will remain subject to its obligations, and member governments agree not to extend any financial aid to it without the Bank's approval. At the end of a year it will be automatically dropped from membership unless restored to good standing by a majority vote. If a country withdraws or is expelled from the Bank, its shares of stock will, if the Bank has a surplus, be repurchased at the price paid. If the Bank's books show a loss such country is to bear a proportionate share of it.

### III

The Treasury's decision to go ahead with its plans for a United Nations Bank for Reconstruction and Development, as evidenced by its publication of the text of the scheme, is of special interest to us, as noted at the beginning of this paper, in view of the position taken by Dr. Williams regarding international financing problems in the transitionary and the longer-run periods. The argument is that if the International Stabilization Fund is used to meet the abnormal requirements for foreign exchange in connection with reconstruction in the early post-war years, borrowing countries will soon have run through their quotas and the Fund will in addition face an acute shortage of American dollars (and perhaps a few other currencies heavily in demand). It is highly unlikely that the Fund's shortage of these currencies could be replenished within a short time by the emergence of sufficiently large active balances on the part of the borrowing countries. The

result would be that the Fund would remain in a lopsided position which would greatly limit its effectiveness or cause it to collapse altogether. The very essence of the Fund, as a currency stabilizing mechanism, is that its assets should be used to finance temporary exchange shortages and not long-term loans which can be liquidated only over a lengthy period of years.<sup>7/</sup>

Dr. Williams' conclusion is that the problem of financing abnormal reconstruction requirements in the transition period should be handled by a separate credit agency, by lend-lease, etc., and that the International Stabilization Fund should, if established at all, be set up only after the transition. In the interim, exchange rates could be maintained by the continuance of exchange controls and perhaps by informal credit arrangements between a few key countries.

The proposed establishment of a United Nations Bank for Reconstruction and Development goes a long way, I believe, toward meeting these criticisms, in that such a Bank should theoretically remove the burden of the long-term financing problem of the transition from the shoulders of the Fund. On the other hand, a series of new questions of importance arise which will have to be answered. These questions, which can be treated only briefly here, are as follows:

- (1) Granted that long-term financing, particularly during the transition period, should be the function of a separate institution, is an international bank, comprising a large number of potential lending and borrowing countries, the appropriate agency for such financing?

---

<sup>7/</sup> Professor Viner has also lent his weight to this point of view recently, as follows: "To put on what is intended to be a long-run monetary stabilization agency any important responsibilities with respect to the handling of the emergency problems of the transitional period. . . would be to put a curse on the agency from the start. . .The emergency salvage and rehabilitation tasks should be left to other agencies specially designed for such purposes. The intermediate and long-term capital needs of non-relief countries should be provided for. . .by agencies appropriate for such functions." Cf. "Two Plans for International Monetary Stabilization," Yale Review, Autumn 1943, pages 28-29.

(2) Assuming the existence of a United Nations Bank for Reconstruction and Development, will there be a role for an International Stabilization Fund during the transition period?

(3) Assuming that the International Stabilization Fund is set up simultaneously with the International Bank for Reconstruction and Development, what will be the respective fields within which each will operate, both in the transition period and in the longer run?

Question (1) is controversial in character, and has as its analogy an International Stabilization Fund versus a key country approach to the problem of currency stabilization. If I understand him correctly, Dr. Williams' opinion on this subject would probably be that such long-term loans should preferably be made, particularly in the transition period, not through a full-blown international bank, comprising a large number of borrowing and lending countries, but directly on a bilateral basis by the countries in a position to lend long-term capital, notably the United States, to the countries in need of such capital. The existence of a world bank could not camouflage the fact that during the transition period it would in fact, be primarily the United States which will be doing the lending. It must be admitted that, not only would an international organization be politically difficult to establish, but it would put potential borrowers in the position of having an important vote in the Bank's decisions, even though the loans for some years would actually be extended by only a few countries. This general issue of an international organization versus a key country approach has already been discussed in some detail by Mr. Wallich and myself in connection with the problem of international exchange stabilization, and there is no point here in going over the matter again. Since my own bias is to establish as many "bigger and better" international organizations as possible, even in the transition period, my preference would be for

the establishment of a world bank. Perhaps, however, a distinction might be drawn between long-term financing in a transition period and in the longer run. In the first case, direct loans on a bilateral basis or through an arrangement between a few key countries might admittedly be preferable. In the long run, however, the international bank would definitely seem to be the appropriate agency, particularly for the reasons elaborated upon in Section I above.

Questions (2) and (3) might perhaps be appropriately discussed together. It seems to me that the existence of a Bank for Reconstruction and Development and of such agencies as the United Nations Relief and Rehabilitation Administration and the Office of Lend-Lease Administration would certainly not obviate the need during the transition period for an agency to provide what would in effect amount to essentially short-term credits. For, in addition to relief requirements and to loans for specific reconstruction purposes, there would still be a "shortage" of foreign exchange for other purposes. The balance of payments structure of many countries, most notably Great Britain, has been seriously disrupted by the war due to such factors as the (presumably temporary) loss of export markets, the loss of overseas investment income, etc., and this fact, in conjunction with a "shortage" of gold and foreign exchange reserves on the part of such countries, will create a balance of payments problem apart from that connected with demands arising out of relief and reconstruction. Since long-term loans through the Bank are to be limited to specific reconstruction or development projects and to the financing of imports required in connection with such projects, there will be a whole range of imports required for the maintenance of reasonable living standards (not to be confused with mere relief) which will have to be financed, unless one assumes that lend-lease

aid will be extended for such purposes. In short, until the balance of payments structures of such countries as Britain are restored by the reconquest of export markets lost during the war and/or by some improvement in foreign investment income, temporary aid will be needed to tide over the balance of payments deficit. This aid would properly seem to be the terrain for a currency stabilization mechanism such as the International Stabilization Fund and not for a long-term investment bank.

In the long run, however, when the so-called transition period is completed, the appropriate fields of activity of the International Stabilization Fund and the world bank will stand out more clearly delineated, the former concerned with providing foreign exchange to countries facing ostensibly temporary deficits in their balances of payments, and the latter with the extension of long-term credits to foreign governments and corporations to provide them with the foreign exchange needed in connection with the construction of specific projects. It seems to me, however, that there is still much work to be done by the Treasury, and a vast field to be explored, in connection with the relationships of these two organizations with each other. It is obvious that the success of the one will be intimately dependent upon that of the other, and it seems to me that because of this the two blueprints which have been drawn up should be more closely synthesised and the respective rules, policies, and operations of the two organizations more closely harmonized. Out of a wide range of problems which might be examined in this sector, particular attention should be directed to the way in which the activities of the one will affect those of the other. As mentioned earlier, long-term lending through the Bank will exert some pressure upon balances of payments, and this pressure may in part be diverted to calls upon the resources of the International Stabilization Fund. Similarly,

the operations of the Fund may require that long-term loans at times be canalized more sharply towards certain countries. I hope to be able to explore some of these issues in a later memorandum.

Foreign Research Division  
A.I.B.  
October 18, 1943.