THE REVISED DRAFT OF THE PROPOSAL FOR A UNITED NATIONS BANK FOR RECONSTRUCTION AND DEVELOPMENT

On November 23 the Treasury publicly released the full text of its draft for a United Nations Bank for Reconstruction and Development. (Previously only a summary of the plan had been made available to the public.) The following notes discuss the changes which have been made in this latest draft of the plan as compared with the October 1 version which I analyzed in an earlier memorandum.[1]

In earlier versions of the plan, the operations of the proposed bank were to be concerned with granting, guaranteeing, or participating in investments exclusively of a fixed-interest-bearing character, and there were no references to the desirability of encouraging the expansion of equity investments, e.g., direct investments, or to the participation of the bank in such. Foreign investments of an equity character, however, have a distinct advantage over bond investments in that the country in which such investments are located is subject, not to fixed interest and amortization payments, but to payments which vary with the domestic level of national income and which tend to be adjusted to the balance of payments position of that country. The absence of any reference to equity investments seemed, therefore, as I pointed out in my earlier report, to have been a notable omission in the draft of the plan. In the latest version, however, specific methods are now suggested to stimulate such investments.[2] In a new clause, the bank is empowered (a) to encourage and facilitate international investment in equity securities by securing government guarantees covering the conversion into foreign exchange

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1/ Cf. The Proposed United Nations Bank for Reconstruction and Development, dated October 18, 1943.

2/ Judging from a recent statement of Secretary Morgenthau, moreover, the Treasury seems to be of the opinion that, even in the absence of special action by the bank, direct investments will tend to be resumed on a substantial scale with the return of peace.

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of the current earnings of such foreign held investments; and (b) in promoting this objective, to participate itself in such investments, though only up to a maximum of 10 per cent of the bank's paid in capital.

During the '30's one of the major obstacles to the growth of direct investments was the widespread extension of exchange controls, which had the effect of blocking the earnings from such investments, making it impossible for the foreign owners to repatriate such income. Under the new provision referred to above under (a), it is intended to remove this particular obstacle by obtaining from the governments in the countries in which such investments are located a guarantee that earnings may be freely transferred. It is not specified, however, in what way the bank will be able to induce the governments concerned to make these guarantees. It would seem to be necessary for the bank to offer a tangible concession in the form of special access to foreign exchange, since it is presumably the inadequacy of such exchange which would cause the country concerned to block the earnings. If such facilities were made available to unfreeze blocked earnings, however, it would seem to involve an illegitimate extension of the primary objectives for which the bank is presumably to be set up and might, moreover, give rise to embarrassing demands upon the bank for the unblocking of other forms of frozen balances. Even if guarantees were secured that earnings from direct investments would not be blocked, moreover, there would still remain other obstacles hampering the expansion of direct investments, notably, hostile action by governments against foreign-owned properties in the form of discriminatory tax legislation, expropriation, etc. This hostility, in fact, may probably have been a more potent deterrent to direct investments during the '30's than was the blocking of earnings from such investments. An appreciable revival of direct investments would thus also seem to necessitate obtaining from the governments of the countries participating in the proposed bank guarantees of "equal treatment" for foreign-controlled as compared with domestic-controlled enterprises.

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The provision described under (b) above, that the bank may itself participate in foreign equity investments up to 10 per cent of its paid-in capital, may have two beneficial effects: (1) It will probably stimulate to a degree private investment in certain foreign enterprises from a belief that the participation therein of the bank will be a factor making for the stability of the enterprises and the safeguarding of their rights; (2) It may pave the way for the creation of truly international corporations in those cases where the international bank itself holds the controlling ownership in the enterprise. (Many students in fact advocate international corporations as the ideal form of foreign investment because of their purely denationalized character, which minimize the possibility of international political friction.) The fact that the bank's participation in foreign enterprises is limited to a maximum of 10 per cent of its paid-in capital probably reflects a belief that investments of this character may be more risky, and subject to greater possible abuse, than carefully selected fixed-interest-bearing obligations.

In the October 1 version of the plan there had been a clause which stated that when a loan project gave rise "to an increased need for foreign exchange resulting from that program," the bank would provide an appropriate part of the loan in gold. As worded, however, that clause was ambiguous and directly inconsistent with the provisions in the plan which stated that the bank would in any case normally provide its loans to a given country only in the form of foreign currencies and only to finance that part of the developmental program which would involve purchases of goods or services from a foreign country. In the latest draft of the plan this ambiguity is to a degree cleared up, but by no means removed, by a more specific wording of the clause in question. It is now provided that where the developmental program gives rise to an increased demand for foreign exchange <u>for purposes not directly needed for that program yet resulting from it</u> the bank will provide an appropriate part of the loan in

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gold or in desired foreign exchange (underlining mine). Reference is undoubtedly made here to the so-called secondary, or multiplier, effects resulting from the program, i.e., to the increased demand for imports arising from the higher level of national income caused when part of the expenditures in connection with the project is directed to domestic goods and services. But if this is what is actually meant, then it is still not clear why reference is merely made to the fact that the bank will in this case provide part of the loan in gold or foreign exchange. (Is not <u>all</u> of the loan <u>in any case</u> to be made in foreign exchange?) It would appear rather that an amount (of foreign exchange or gold) in <u>excess</u> of the loan proper should be extended so as to enable the borrowing country to finance, not merely the demand for imports in connection with the borrowing project itself, but the increased demand resulting from the higher level of national income.

The other "major" revisions in the latest draft of the plan relate to the omission of several clauses which had appeared in the earlier drafts. The following clauses do not appear in the latest version of the plan.

1. The provision that any loan guaranteed, participated in, or made by the bank could be repaid, at the option of the borrower, in whole or in part, at any time prior to its maturity, and the provision that the bank may arrange for the refunding through government or private financial channels of any loan guaranteed, participated in, or made by the bank.

2. The provision that no country shall be obligated to increase its subscription to the shares of the bank, but that it may at any time acquire additional shares from the bank.

3. The provision that the bank may postpone for a year or more action on a proposed loan at the request of the representative of the country in which that loan is to be spent. This provision was presumably dropped because it was already covered in large part by the clause that the bank would, in making a loan, provide the foreign exchange requested by the borrower only with the consent of the country whose currency was thus made available.

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