

## THE PROPOSED UNITED NATIONS BANK FOR RECONSTRUCTION AND DEVELOPMENT

On November 24, 1943, the Treasury made public the preliminary draft of a proposal to establish a permanent international investment bank. The new institution is designed as a "companion agency" to the International Monetary Fund, although it is expected that either agency could function effectively alone. It is the purpose of this memorandum to outline briefly the salient features of the proposed international investment bank and to point out some of the advantages and disadvantages which might be expected to accrue to the United States in the event of its adoption.

### Structure and Functions of the Bank

The purpose of the Bank is to assist in the reconstruction and development of member countries by (1) cooperating with private financial agencies in the provision of sound investment capital and (2) providing sound investment capital when private financing agencies are unable to supply the needed funds on reasonable terms.

To the extent that these two purposes are well served, it is believed that the transition to a peacetime economy will be facilitated, the productivity of member countries will be raised, and the long-range balanced growth of international trade will be promoted.

The total authorized capital of the Bank is set at about \$10 billion. Member countries will subscribe to shares of stock in accordance with a formula to be determined later. However, it is suggested that the appropriate subscription for the United States would be \$3½ billion, for England \$1 billion, and for Russia slightly less than \$1 billion. Subscriptions are to be paid in instalments and are to be partly in gold and partly in local currency. A substantial part of the subscribed capital is to be reserved in the form of unpaid subscriptions as a surety fund for securities guaranteed or issued by the Bank.

The Bank is authorized to guarantee, to participate in, or to make loans to any member country or (through the government of that country) to any of its political subdivisions or business enterprises, provided the following conditions are met. Payment of principal and interest must be fully guaranteed by the national government; the borrower must be unable to secure the funds from other sources on reasonable terms; a competent committee must recommend the loan as sound; the proper use of the borrowed funds must be assured; and reasonable rates of interest must be charged and an appropriate repayment schedule provided. In making loans, the Bank undertakes to provide the necessary foreign exchange and gold. To encourage investment in stocks, the Bank may secure the guarantee by national governments of the conversion into foreign exchange of the current earnings on such foreign-held stocks; indeed, up to ten per cent of its capital, the Bank can acquire such stocks. Payment of principal and interest on loans is to be made in currencies acceptable to the Bank or in gold. In the event of an acute exchange shortage, local currency under repurchase option may be accepted for periods up to three years.

The Bank is given broad borrowing powers. It may issue, buy or sell, pledge, or discount its own obligations or securities from its portfolio. It may borrow from member governments, fiscal agencies, central banks, stabilization funds or private banks in member countries, or from international financial agencies. It may buy or sell foreign exchange. No over-all limits on the borrowing or lending operations of the Bank are prescribed.

In its credit activities, the Bank must deal only with or through the governments of member countries, their central banks, stabilization funds, and fiscal agencies, or through the International Monetary Fund or similar agencies predominantly owned by member countries.

The Bank is to be managed by a Board of Directors composed of one director and one alternate appointed by each member country. Voting by the Board is to be in proportion to shares of stock held. Each director is entitled to 1,000 votes plus one vote for each share of stock owned. No director, however, can cast more than 25 per cent of the aggregate votes. Virtually all decisions are to be made by simple majority vote.

Member countries may be suspended if declared to be in default on their obligations, but are eligible to reinstatement on majority vote of the member countries. Provision is also made for voluntary withdrawal from the Bank.

#### Advantages to be Expected from the Bank

It is generally agreed that the postwar demand for capital funds with which to reconstruct war-devastated areas will be large. In addition, there will be an incommensurable foreign demand for investment funds with which to develop new industrial capacity and to make public improvements. There is also general agreement that such lending soundly done will benefit borrower, lender, and the world at large.

In the postwar period, most nations will be would-be borrowers of capital funds. The United States and some few smaller countries will be potential lenders. Certainly this will be the case in the immediate postwar period. American experience with foreign investments has been far from satisfactory in the past twenty years. This experience coupled with the generally weak credit rating of most foreign borrowers after the war means that it will be difficult to place any large volume of foreign securities with American investors for some time. The United Nations Bank proposal represents an effort to overcome that difficulty by reducing the credit risk inherent in postwar

foreign investment. True, the plan is not aimed specifically at American investors, but it is obvious that the bulk of such lending must come from the United States.

If the Bank is established and if it proves to be successful, a large volume of foreign securities will be sold to American investors and a large volume of loans will be made by the Bank to foreign borrowers. Among the resulting advantages to the United States would be these. First, the volume of our exports would expand as we loaned funds with which to purchase our goods. Later on of course, as the loans were paid off, our balance of trade would be reversed as foreigners must sell us goods and services in order to get the dollars with which to meet principal and interest payments. Second, American investors would have a new outlet for their savings. Whether this would prove advantageous in the long run would depend on the quality of the loans made. Third, the productive capacity of foreign borrowing nations should be increased, leading to a higher level of business activity and a better scale of living. To the extent that this occurred, the United States could be expected to benefit, at least indirectly.

#### Disadvantages to be Expected from the Bank

So long as the Bank operated effectively, i.e. made or guaranteed sound loans on reasonable terms and the loans were repaid according to contract, there would be no disadvantage to the United States except in the matter of accepting repayment. As stated earlier, a creditor nation status involves an import surplus and we must be prepared to accept that situation. This implies the more or less gradual adoption of a free trade policy which would certainly cause considerable industrial dislocation. It is possible also to object to the Bank on the principle that government-guaranteed lending is unsound.

The real danger in the plan would seem to lie in the possible or perhaps probable abuse of its lending and guaranteeing power. In other words, there is danger that unwise loans and guarantees will be made which will result in outright losses to the Bank or repayment of loans in worthless foreign currencies. It is reasonable to believe that the credit standards of the Bank will be lower than those of private lenders, especially since the management will be controlled by borrowing countries. Indeed one advocate of the Bank is on record as favoring the extension of certain loans even though they cannot return the principal and interest or even all of the principal. To the extent that the Bank suffers losses, the United States as the largest share holder will be the biggest loser. Further, there is every reason to believe that, if the Bank gets into difficulties, the United States will be called upon to increase its capital contribution.

A second danger lies in the terms on which loans might be made. The plan specifies "reasonable terms". If this is interpreted to mean excessively long loans and extremely low interest rates, the Bank could easily drive all private investors out of the field.

#### Conclusion

It is unquestionably desirable that necessary credit be made available to foreign countries in the immediate postwar period. However, it would seem wise to confine present planning in the foreign loan field to this transition period and to defer consideration of a permanent program until a clearer picture of the postwar world emerges. Once international stability has been achieved, it is entirely possible that private sources can provide the necessary investment funds to foreign borrowers.

For the short-run transition period, however, some sort of emergency lending agency would seem to be almost essential. Much, perhaps all, of the

necessary relief and rehabilitation should be given outright via lend-lease. Reconstruction and development loans might well be made via some government guaranteeing agency because of the high risk element involved. Whether this agency should be international in character or entirely American is another problem.