BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 25, 1946.

To Chairman Eccles

Subject: Summary of matters under discussion in the Staff Committee.

From Mr. Knapp

TAK

The following is a summary of the matters which have been under discussion in the Staff Committee during the last two or three weeks. A number of them will be ready for consideration by the National Advisory Council when it resumes meetings.

1. Council procedure in exercising supervision over American Executive Directors in Fund and Bank. You will recall that I sought clarification of this issue at a Staff Committee meeting many weeks ago, at which time discussion of the matter was judged by the Committee to be premature. The issue has now been raised in concrete form by Pete Collado's request for Council guidance on certain technical matters confronting the Executive Directors in the Bank. As I have reported to you verbally, the Treasury has been "dragging its feet" in working out a response to Collado's request and there is a general suspicion--shared by Collado--that this is due to a desire on the part of the Treasury people to avoid setting a precedent which would hamper Harry White's freedom of action. Up to now Harry has not requested any policy guidance from the Council and has submitted no oral or written report to the Council concerning the issues which have been arising in the Fund meetings.

One of the methods which the Treasury has used to stall on Pete's specific requests has been to suggest the preparation of a general statement of procedure covering the relations between the Council and the American Executive Directors. The Staff Committee is at present working on this statement. Walter Gardner and I have been urging that it provide for the maximum disclosure of information to the Council by the Directors. We recognize, however, that it is extremely difficult to lay down in such a document any rules as to when the Directors should seek the guidance of the Council; probably this must be left to the discretion of the Directors, except that the Council, if it were furnished with full information as to the issues developing, could intervene on its own initiative whenever this was thought necessary.

I am writing you a separate memorandum on the provisions of the Bretton Woods Agreements Act relating to the relationship between the Council and the Directors.

2. Special Export-Import Bank credits on foreign sales of aircraft. You will recall that the Export-Import Bank people have talked from time to time about developing further "commodity loan" programs analogous to the 100 million dollar cotton credit. They have now come up with a proposal for allocating 100 million dollars of Eximbank funds to finance the export

of aircraft (including aircraft and airport equipment).

There are two arguments for special credits of this type which would distinguish them from other "commodity credits":

a. To the extent that the provision of such credits would increase the export of American aircraft ~~or domestic aircraft~~, a valuable stimulus would be given to our domestic aircraft industry, which should be kept operating at as high a level as possible in view of its importance to national security. Of course in quantitative terms this stimulus could not be very important. It would be surprising if the initiation of this special credit program would increase exports of American aircraft by more than 100 planes a year. While this would be a substantial addition to the demand for civilian aircraft, it seems clear that the maintenance of our domestic aircraft industry must be dependent mainly upon Army and Navy procurement, which it is hoped will run to several thousands a year.

b. To the extent that foreign airlines use American planes, the ability of foreign countries to earn dollar exchange by providing air transportation will be increased. Some foreign airlines might simply be unable to commence operations if they could not get American planes on credit, and others would have to equip themselves with foreign planes on which American tourists and businessmen might be unwilling to travel. Hence it can be argued that to some extent at least the proposed financing would not only stimulate present American exports of aircraft but also future American "imports" of air transportation services.

The general principle of extending credit to finance the export of aircraft has been enthusiastically endorsed mainly on the basis of the first argument cited above by the Air Coordinating Committee representing the State, War, and Navy Departments.

In the course of the Staff Committee discussions it has become recognized that, at least until the Export-Import Bank gets additional funds, not more than 25 million dollars could be allocated to this program. This sum might provide the basis for financing aircraft exports of several times that amount since the Eximbank would require the aircraft manufacturers to bear some share of the risk (say 20 per cent) and would further expect to get a large measure of private capital participation.

I was at first extremely skeptical about this whole proposition but have found myself in a minority of one in the Staff Committee. I am now swinging around to the view that if we accept the proposition that 100 million dollars of Export-Import Bank money should be reserved for exporter credits, the allocation of 25 million dollars to aircraft credits is not unreasonable.

After all, these credits have much more to be said for them (see above) than can be said for credits to finance exports of railroad equipment, machinery, machine tools, etc.

3. Loan to the Philippines. The Philippine Government has applied to the Export-Import Bank for a loan of 250 million dollars to cover an anticipated balance of payments deficit during the next three years. Upon analysis of the Philippine position, however, the Staff Committee has concluded that no such balance of payments deficit should develop, especially in view of the large military expenditures which we will continue to make in the Philippines during the next year or so.

At the same time, however, the Philippine Government has approached the Treasury for a loan of 400 million dollars during the next five years to cover estimated internal budgetary deficits. The Philippines do not have a central bank and under present law their currency must be covered 100 per cent by dollar reserves. Hence if they desire to create pesos to cover their internal budgetary deficits they must borrow a corresponding amount of dollars to carry as a reserve.

The Staff Committee has not yet been able to accumulate sufficient data concerning the Philippine budgetary position to determine whether the Philippine estimates of their deficit are reasonable. It is proceeding with a study of the facts and of the possible steps which the Philippine Government might take to meet the situation. In addition, the Staff Committee has agreed that if a dollar loan to cover an internal Philippine deficit does prove necessary such a loan should not be made by the Export-Import Bank. In other words, in all likelihood special legislation will be required.

4. Loan to Italy. The loan to Italy is still stalled where it has been for some time because of the uncertainty concerning the outcome of Italian reparations at the Paris Conference. I shall only call your attention to the fact that on June 18 Mr. Bevin on behalf of the United Kingdom proposed that the four great powers renounce all claims to reparations from Italy in order to give Italy "a far better chance of recovering and prospering as a democratic state". In particular, Mr. Bevin attacked the idea that Italy should pay reparation out of current production. Needless to say, his argument was not accepted by Mr. Molotov and the issue remains in dispute. Meanwhile, I understand that UNRRA has stepped up its program of aid to Italy during the current months but without increasing the total UNRRA allocation to Italy. This is all right as a stopgap measure but will mean that Italy's needs will be even more acute during the last part of the year.

5. Loan to Brazil. Brazil has applied to the Export-Import Bank for a long-term loan of 350 to 400 million dollars to finance a 5-year program of development for the Brazilian transportation and communication systems. The State Department and the Eximbank are pressing for an initial commitment to Brazil of 25 million dollars. I am taking the position that no loan to

Brazil at the present time can be justified in view of the fact that she has accumulated huge gold and dollar reserves during the war which could be used for her purposes. Brazilian gold and dollar reserves at the end of 1945 were around 650 million dollars as compared with only 50 million before the war. These reserves are nearly double the value of Brazil's imports in 1939 (adjusted for price rise) and 1-1/2 times the value of 1945 imports.

6. Loan to Turkey. Turkey has applied to the Export-Import Bank for a long-term loan of 500 million dollars to carry out a program of industrialization. Everyone regards this request as fantastic, but the State Department is supporting the allocation of 25 million dollars to Turkey (in the form of exporter credits) as a political gesture. Again I cannot feel that this is justified. Turkey too has accumulated relatively very large gold and dollar balances during the war. Official holdings amounted to 270 million dollars at the end of 1945 as compared with 34 million at the end of 1939. We have recently made a very favorable Lend Lease settlement with Turkey (why neutral Turkey should ever have gotten Lend Lease is something of a mystery) as well as a 10 million dollar surplus property credit. I doubt whether a further 25 million dollars of Eximbank credits would have great political value.

7. Cotton deals with Germany and Japan. The Staff Committee has been looking into the special cotton deals which agencies of the Government have been negotiating with Germany and Japan to determine whether or not the National Advisory Council should "coordinate" such activities. These deals involve the shipment of cotton to Germany and Japan through military channels, payment being obtained on a deferred basis in the form of cotton textiles manufactured in those countries. Although these are barter transactions, they are also clearly credit transactions but in view of their very special nature the Staff Committee has considered it best simply to report them to the Council for its information. It recommends no action by the Council in connection with these credits.

8. Sales to foreign governments of domestic surplus property. The War Assets Administration has agreed to accept responsibility for selling domestic surplus property on credit to foreign governments, but desires to attach to such credits the same terms as it applies to sales to domestic purchasers, namely maturities of up to five years and interest at 4 per cent. The general feeling in the Staff Committee, which is shared by me, seems to be that these transactions by War Assets Administration should be financed on the same basis as sales of surplus property by the Foreign Liquidation Commissioner, i.e. on 3c terms. To the objection that this would discriminate in favor of foreign governments as against domestic purchasers, we would argue that this discrimination is justified by the general purposes of our foreign lending program, namely world reconstruction and the promotion of economic and political stability abroad. The War Assets Administration would be free to reserve any "choice" surplus property for domestic purchasers and to sell abroad only such supplies as cannot be liquidated in this country.

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