


Date December 11, 1946.

To Chairman Eccles

From Mr. Knapp 

MESSAGE:

URGENT--This covers subject to be discussed at National Advisory Council meeting and lunch with Mr. Collado tomorrow.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 11, 1946.

To Chairman Eccles

Subject: Subjects to be discussed at
National Advisory Council meeting
tomorrow.

From Mr. Knapp 

The Staff Committee has completed its work in preparation for the Council meeting tomorrow at which the Bank's loan program will be discussed, but I have not yet received copies of the final documents. In the meanwhile, I should like to inform you briefly concerning our conclusions.

1. The initial country program for the Bank's loans. It is recommended that the Council approve favorable action by the U.S. Executive Director on the following loans from the International Bank: France, 250 million dollars; Chile, 30 million dollars; Poland, 75 million dollars, provided that satisfactory assurances are received by the Bank from Poland concerning the continued flow of Polish coal to Western Europe. The Staff Committee tried to draw up a specific formulation of this assurance but this is very difficult to do. We were assured by those most familiar with the situation that Poland had every interest in continuing shipments to the West because they needed the free exchange at the present time, and because they wanted to protect their markets there for the future. The possibility remains that sometime Poland might be swallowed up in the Russian system, but of course this could not be avoided merely by asking the Poles to promise not to.

On the Danish loan application for 50 million dollars which Mr. Collado has asked the Council to approve and which the Staff Committee previously recommended cutting down to 25 million dollars, we are now recommending that the Council approve a loan to Denmark in principle and reserve its judgment as to the figure until more information as to the Danish program is available. The main difficulty in this case is not repayment prospects, but rather lack of data on which to base judgment of Denmark's need for assistance.

2. Question of Council control over the Bank's loan program. I am attaching a section which I wrote for the Staff Committee report to the Council and which was accepted by the Committee with only a few verbal changes. This is a somewhat rewritten version of a paper which I sent you some days ago.

The question which it discusses is that of whether the Council desires to exercise a direct loan-by-loan veto power over the dollar lending operations of the Bank. It does not attempt to answer this question but explains the problem and asks the Council to make a decision.

I do not have much to add to what is said in the attached paper, which is highly important and which I hope you will be able to read. My personal view, however, is that it would require a great deal of stretching and straining with the Articles of Agreement to give the Council a loan-by-loan veto power over the Bank's operations and that it is really unnecessary to attempt this in view of the fact that the Council already has almost unchallengeable working control over the Bank through the vote of the U.S. Executive Director and through its power to withhold consent to future debenture issues by the Bank if at any time the U.S. Executive Director finds himself overridden in the determination of the Bank's loan policy. At least we might start out this way and only seek a more rigid control if events show that the general controls are insufficient.

Attachment

4. U.S. Assent to Use of 18 Per Cent U.S. Capital Contribution and to Issuance of Debentures in U.S. Market.

The Council is given broad authority under the Bretton Woods Agreements Act to give the consent of the U.S. to operations of the International Bank and Fund when such consent is required under the Articles of Agreement of the institutions. It is necessary for the Council to consider at the present time whether, in exercising this authority, it desires to assert a direct loan-by-loan veto power over the dollar lending operations of the International Bank, or whether it would be satisfied to exercise more general control through the vote of the U.S. Executive Director (at present 37 per cent of the total) and through the power to withhold consent to future debenture issues if at any time the U.S. Executive Director finds himself overridden in the determination of the Bank's loan policy.

Both courses of action would appear to be feasible under the Articles of Agreement (with some possible qualifications to the former), although it was clearly not anticipated at Bretton Woods that the U.S. would exercise complete loan-by-loan control. Article IV, Section 2(a) of the Articles of Agreement provides that the 18 per cent capital contribution of member countries "shall be loaned only with the approval in each case of the member whose currency is involved". A strict reading of this provision (in particular of the words underlined) would appear to give the U.S. a veto power over loans from its 18 per cent capital contribution, although this clause was designed mainly to

protect countries which might not be able to afford the export of capital because of weakness in their balance of payments position. The Articles of Agreement also provide for consent by the U.S. (presumably specific consent in each case) to the flotation in this market of any loans guaranteed by the Bank. On the other hand, the clauses regarding debenture issues by the Bank merely provide that such issues must be approved by the member in whose market they are made. As if to underline the intention not to give member countries a veto power over loans made from the proceeds of debentures, Article IV, Section 2(d) of the Articles of Agreement provides that such proceeds "shall be used by the Bank . . . without restriction by the members whose currencies are offered". It is clear therefore that the U.S. can exercise direct loan-by-loan control over the Bank's operations only to the extent that the Bank can be prevailed upon to use the guarantee procedure or, when it makes advances on direct loans, to make them out of the U.S. 18 per cent capital contribution rather than out of its 2 per cent funds or the proceeds of debentures.

It would obviously be undesirable to force the Bank to use the guarantee rather than the direct loan procedure, and the Bank has already decided to commence operations on the latter basis. Furthermore, there is no way to restrict the Bank's use of the 150 million dollars of 2 per cent gold and dollar capital contributions by member countries. The question remains, however, of whether the U.S. could insist under the Articles of Agreement upon the Bank's using the 18 per cent U.S. capital contribution rather than debenture money to make all advances on direct dollar loans not financed by the 2 per cent funds.

At present, according to the U.S. Executive Director, the Bank plans to make its first loans out of the U.S. 18 per cent money (571 million dollars), and at the same time to obtain U.S. assent to the issuance of a corresponding amount of debentures in order to keep some 500-600 million dollars of uncommitted lending authority available to meet new commitments. The Bank would not necessarily issue these debentures at once, since disbursements on loans will lag far behind commitments and the Bank wants to avoid holding an excessive amount of idle borrowed funds. However, the U.S. Executive Director suggests that initially the Bank might accumulate idle funds of about 1 billion dollars, to be reduced later on to 500 million.

If the Bank makes its first loan disbursements out of the U.S. 18 per cent capital contribution until these funds are fully lent out, subsequent disbursements will all be out of debenture money over which the U.S. will have no direct control. However, the Bank has not proposed this program in order to escape U.S. control (which in any case will be very close) but rather because it would thereby be enabled to earn a greater amount of badly-needed revenue; idle funds held in the form of U.S. 18 per cent money would have to be placed in non-interest-bearing demand notes whereas the same funds held in the form of debenture money could be invested in interest-bearing U.S. Treasury securities.

Under these circumstances, if the Council assents to the Bank's issuing debentures, it will not be able thereafter to exercise loan-by-loan control over the Bank's operations. Furthermore, under the Articles of Agreement, the U.S. cannot qualify its assent to debenture issues by requiring that the proceeds be used to meet existing loan commitments on

which the approval of the U.S. has been obtained. It is possible that other methods can be found to achieve part or all of this result, but before proceeding further the Staff Committee desires to obtain the Council's views as to the basic policy issue involved.

The Staff Committee would like to point out that the assertion by the U.S. of a direct loan-by-loan veto power over the dollar lending operations of the Bank (so far as this is feasible), aside from being contrary to the expectations at Bretton Woods, might have certain positive disadvantages from the point of view of the U.S. It would require the Council to assume a direct responsibility for International Bank loans comparable to that which it has undertaken in connection with Export-Import Bank loans. The Council already has almost unchallengeable working control over the Bank through the vote of the U.S. Executive Director and through its power over debenture issues in the U.S. market. An attempt to make this control even more rigid would imply a distrust of the Bank and of other member countries which might well arouse their antagonism and impair the usefulness of the Bank as an instrument of international economic cooperation.