BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 20, 1946.

Dear Mr. Chairman:

Since I reported to you on various National Advisory Council developments in my letter of September 6, the subjects listed in that letter have been considered further and new matters have arisen. The following is a summary of developments to date, dealing first with the items listed in my previous letter.

1. War Assets Administration Credits. As predicted, the Council insisted upon using in the case of War Assets Administration credits the same language as is used in the case of the Export-Import Bank, i.e. that the Council "approves the consideration" of the proposed credit by the War Assets Administration. The W.A.A. is not at all happy about this conclusion and possibly they may desire to raise the question again or they may refuse to grant any credits to foreign governments in the absence of a more specific statement by the Council of the ability of the foreign country to repay.

2. U.S. Government Commission to Greece. As far as I know, the State Department has taken no positive steps toward the formation of such a Commission. Perhaps it is waiting to see and analyze a thorough report on the Greek situation which was prepared for the United Nations Food and Agriculture Organization by a special commission, of which Mordecai Ezekiel was a member. Incidentally, following a number of rumors in the press, Mr. Clayton announced at a press conference the other day that consideration was being given to the provision of post UNRRA assistance to Italy, Greece, and Austria through outright grants from this country. Of course such a program would require new Congressional legislation.

3. Surplus Property Settlement with China. Tom McCabe appeared at the N.A.C. meeting on September 10 and reported on the agreement which had been signed with the Chinese as well as on the agreement in principle which he had reached with the Philippine Government.

The Chinese deal is approximately as described in my previous letter, except that we agreed to pay 30 million dollars in cash (taken from War Department appropriations) on our obligation to China for yuan currency supplied to our armed forces. The Chinese claimed that they needed this 30 million dollars to cover the cost of packing and shipping the surplus property which they acquired in Pacific areas outside China. The Chinese also tried very hard to get assurance of a 30 million dollar Export-Import Bank loan to cover the cost of purchasing spare parts for surplus property acquired under this deal. No such assurance was given but General Marshall did agree to write a letter to the Export-Import Bank recommending that such a loan be approved under the 500 million dollar line of credit, provided that the Chinese established the need for such a sum. Actually it will be many months before the Chinese will have been able to take inventory of the surplus which they have bought and of their need for spare parts.

The general pattern of the Philippine transaction is very similar to that of the Chinese deal. The Philippines are to acquire all surplus property located in the Philippine Islands (original cost estimated at 500-600 million dollars) in return for:

(1) Satisfaction of the clause in the Philippine Rehabilitation Act which grants 100 million dollars fair value in surplus property to the Philippine Government;

(2) Cancellation of the Philippine claim on the U.S. Government with respect to currency issued by Philippine guerrillas with our Army's guarantee during the Japanese occupation (except that we will pay 20 million dollars cash on this claim, the fair value of which we estimate at 55 million dollars), and

(3) 15 to 20 million dollars worth of peso credits to be used by this Government for expenditures in the Philippine Islands (diplomatic and consular establishments, scholarships, etc.).

Note that neither the Chinese nor the Philippine deals result in the setting up of any long-term credits.

4. Italy's Candidacy for Membership in the Fund and Bank. No new developments to report. Italy's candidacy will be supported by the U.S. Government at the Board of Governors meeting along with that of Turkey, Syria, and Lebanon.

5. Secrecy in Fund's Consideration of Proposed Changes in Exchange rates. At the National Advisory Council meeting of September 10, Harry White gave a rather fuzzy report on the reaction of his fellow Directors to the idea that Harry would have to consult with the N.A.C. on proposed rate changes. He indicated that the other Directors were rather unhappy about this but he expressed the view that "the matter could be worked out". In any case, it appears that no internal Fund regulation will be established at the present time limiting Harry's freedom of action in reporting to the National Advisory Council.

Furthermore, the Fund has now sent out notices to member countries asking them to state the initial exchange rate which they would like to see adopted for their currencies without giving any assurance as to what degree of secrecy would be maintained in case a country proposes an initial rate differing from the existing one.

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Now for new subjects.

6. Value of the Dollar in Initial Operations of the Fund. In response to the Fund's request to all member countries, the Secretary of the Treasury with the approval of the Council, has advised the Fund that the value of the dollar for the purposes of the initial operations of the Fund is to be the value fixed in January 1934, i.e. 35 dollars per ounce of fine gold. His letter to the Fund has been made public in order to allay any rumors which might still be floating about concerning possible devaluation of the dollar in terms of gold.

7. Loans Sponsored by the League of Nations. At its meeting of September 10, the Council passed an action expressing its view that the United Nations Economic and Social Council should not take over responsibility for administering loans to various Central and Eastern European countries which were made during the '20s under the sponsorship of the League of Nations. A proposal of this character has been put forward by the British in the United Nations Economic and Social Council (now meeting in New York), but the Council felt that the British proposal was a first step toward using the Economic and Social Council as a collecting agent on these loans, all of which are now in default.

8. Loan Policy of the International Bank. I am enclosing two papers relating to this subject, one being the text of Pete Collado's report to the National Advisory Council on discussions of loan policy in the International Bank and the other being the paper prepared by the Staff Committee on the same subject. I am sure that you will find yourself in agreement with the action taken by the Council, which followed the Staff Committee's recommendation except for the penciled change.

Briefly, the issue was whether the International Bank should in general limit its activities to loans for the construction of specific capital installations (railroads, harbors, hydroelectric projects, etc.) or whether it should also make loans for general reconstruction and development purposes. Mr. Meyer and some other people in the Bank appear to have leaned toward the former conception of the Bank's operations, but any rigid application of this policy would prevent the Bank from doing a major part of the reconstruction job in Europe and would thrust additional burdens upon the Export-Import Bank. Especially with this latter consideration in mind Collado has pressed for a broad interpretation of the Bank's powers and functions and has received the Council's support for this view.

In connection with this matter, Collado reports that the Executive Directors of the Bank will shortly issue a formal interpretation of the Bank's Articles of Agreement affirming the Bank's authority "to make or guarantee loans for programs of economic reconstruction and the reconstruction of monetary systems, including long-term stabilization loans". You will recall that an interpretation of this character was asked for by Congress in Section 12 of the Bretton Woods Agreements Act.

9. French Quota in the Fund. The French have announced their intention to apply for a higher quota in the Fund at the forthcoming Governors meeting. It is generally agreed that the quota given France at the Bretton Woods Conference (450 million dollars in both Fund and Bank) is too small when measured by any objective criteria, largely because at the time of Bretton Woods the French bargaining position was pretty weak (it was still largely under German occupation). On the basis of the economic formula which provided a general guide to the fixing of Fund quotas, France would be entitled to a quota of around 550 million dollars. However, China has a quota of only 550 million and it would undoubtedly provoke a major political dispute if the relative ranking of the great powers in the Bretton Woods Organizations was disturbed. After thorough discussion of this situation, the Council decided at the last meeting to instruct the U.S. Executive Director in the Fund to consider the French case on its merits, but not to support any increase in the French quota to a level equal to or exceeding the Chinese quota. In practice this means that the French quota might be fixed at 525 million dollars, or possibly at a higher figure if the Chinese quota were also raised. If any change in the Chinese quota is contemplated, the Council will no doubt be consulted again by the U.S. Executive Director. It was further specified by the Council that no change should be made in the French quota in the Fund unless an equivalent change is made in the French subscription to the Bank.

This general question of quotas will probably receive a great deal of attention at the Governors meeting, and I shall report to you more fully concerning this subject when you return.

I am very sorry that you will not be able to return to Washington in time for the meeting with the Aldrich Committee next Thursday. It is planned for the Council to meet and transact its regular business on Thursday afternoon, following which the members of the Aldrich Committee will be invited to join the party. It is pretty clear that this first meeting will be largely a preliminary and exploratory discussion.

With best regards.

Sincerely yours,

Burke

J. Burke Knapp,
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Enclosures 2

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