

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 7, 1947.To Chairman Eccles
From Mr. Knapp *AK*Subject: Report on proceedings of
National Advisory Council meeting
held on January 7, 1947.

The following is a report on the proceedings at the National Advisory Council meeting this afternoon.

(1) Instructions to American members of American-Philippine Financial Commission. The Council approved without change the Staff Committee's recommendation on instructions to the American members of this Commission. These instructions (see pages 4-5 of N.A.C. Document No. 315 attached) emphasize the desirability of exploring methods which would maximize the contribution of Philippine resources and minimize the dependence of the Philippines on additional foreign credits. Among the matters which the American members of the Commission are instructed to give attention to are:

"4. Banking reform, particularly the possibilities of employing existing banking facilities more effectively in promoting economic recovery and of taking steps toward the establishment of a central banking system.

"5. Monetary reform, particularly the possibility of freeing such part of the present currency reserves as might be considered excess to an adequate margin of safety."

(2) Agreements between the United Nations and the International Monetary Fund and Bank. The Council approved the recommendation of the Staff Committee that the U.S. Directors in the Fund and the Bank be instructed to negotiate as close working relationships as possible between those institutions and the United Nations, but to submit the administrative budgets of the institutions to the United Nations for information purposes only. In view of the special setup and voting power in the Fund and the Bank, which differ from those in other specialized agencies of the United Nations, it is obviously impracticable for these institutions to submit to review of their budgets by the General Assembly of the United Nations.

(3) Polish loan request to International Bank. The Staff Committee had come up with a new formula by which the Bank would bind Poland to supply coal to Western Europe, but the whole matter was deferred at the request of Mr. Clayton and Mr. Harriman who indicated that they desired to wait the results of the Polish election which is to be held on January 19. As you know, there is every expectation that this election will prove to be a "strong arm" affair and not a free and democratic election as was promised by Poland in the Yalta and Potsdam Agreements.

(4) Finnish request for Export-Import Bank credit. The proposal for a 25 million dollar Export-Import Bank loan to Finland either by a direct government loan or through exporter credits was approved, although Bill Martin indicated that the Eximbank might well find after further investigation that it might not want to go as far as the Council had authorized.

(5) Mexican and Bolivian requests for Export-Import Bank credit. The Council approved Export-Import Bank loans to Mexico and Bolivia of 5 million dollars each. These loans did not receive much discussion because of their small size, and in the case of the loan to Bolivia the Eximbank argued that the only way to get projects completed in which it had already invested substantial sums was to make this additional money available.

(6) Oral report by Mr. Collado on affairs of the International Bank. Mr. Collado reported that despite the lack of a President, the Bank was making very substantial progress in planning its operations, i.e. in reviewing loan applications, in preparing for the issuance of debentures, and in making decisions as to financial policy. (In fact he gave the impression that action was now being expedited since the President's office was no longer a bottleneck.)

He reported on the status of the Bank's examination of various loan applications. His most interesting disclosure was that the Bank's loan committee will shortly report to the Executive Directors that the whole 500 million dollar loan requested by France is economically justifiable and a proper loan for the Bank to make. Mr. Collado reported, however, that there was agreement in the Board of Directors that the initial installment on this loan should not exceed the sum of 250 million dollars approved by the National Advisory Council. He pointed out that it might be necessary when announcing this loan to make clear that the immediate granting of only half of the French request was not intended to prejudice consideration by the Bank of the other half at a later date. The Council agreed to leave this matter in the hands of Mr. Collado, on the understanding, of course, that no commitment would be made in such a statement.

On the subject of the Bank's program for issuing securities in this market, Mr. Collado said that a great deal of the technical work had been accomplished and that a draft prospectus for the Bank's debentures had been submitted to the Securities and Exchange Commission. He indicated concern, however, as to the progress of the legislative program and said that a great deal of work would have to be done in the next few weeks to get favorable action in the various States with regard to insurance company and savings bank investment in these securities. He also expressed the view that the reputation of the Bank in the New York financial community had suffered considerably not only from Mr. Meyer's resignation but from the fact

that the New York investment banking community had not been adequately consulted and informed concerning the Bank's activities and program. (Again he implied strong criticism of Mr. Meyer.)

Mr. Collado went on to a detailed discussion of the question of the Bank's earning power, of the rate of interest it would have to charge on loans, and associated matters. His conclusion, which he said was the tentative conclusion of the Board of Directors of the Bank, was that on long-term loans the Bank should charge 3 per cent interest payable from the date of commitment, and 1 per cent interest for accumulation in the Special Reserve payable from the date of disbursement. The N.A.C. Staff Committee has been giving study to this same problem and I will shortly prepare for you a more complete memorandum on the subject.

Attachment

(N.A.C. Document No. 315)

MEMORANDUM TO: National Advisory Council

From: The Staff Committee

Subject: National Advisory Council's Instructions to American
Members of American-Philippine Financial Commission

I. Imminent Activation of the American-Philippine Financial
Commission

The American section of the Commission has now been formally constituted and a technical staff is being organized. It is anticipated that the Philippine Government will shortly complete the designation of the Philippine members and that the work of the Commission will begin some time in January.

II. Terms of Reference

The American Ambassador to the Republic of the Philippines formally proposed the establishment of the Commission to the Philippine Government in a note dated September 13, 1946. This note proposed that the terms of reference of the Commission should be to consider the financial and budgetary problems of the Philippine Government and to make recommendations thereon to the two Governments, with reference to the tax system and its administration, the budget, public debt, currency and banking reform, exchange and trade problems, reconstruction and development. The Philippine Government was also informed that the Commission could not be empowered to consider the Philippine Government's application for an Export-Import Bank loan, as the Export-Import Bank and the National Advisory Council could not delegate this responsibility. It was pointed out, however, that the findings and recommendations of the Commission would be brought to the attention of the Export-Import Bank and the National Advisory Council and would be of the utmost value to these agencies in their consideration of specific problems.

The Philippine Foreign Office in a note of September 17, 1946, to the American Ambassador accepted the proposal for the establishment of the Commission, stating that it approved "the plan to entrust to the proposed Commission the consideration of the financial and budgetary problems of the Philippine Government and the formulation of recommendations to the two governments of measures to meet budgetary deficits of the Philippine Government." The note also approved the inclusion of the specific problems listed in the American proposal, as noted in the paragraph above, within the scope of the Commission's inquiry.

III. Intent of the National Advisory Council

The intent of the National Advisory Council in initially proposing the establishment of the Commission was outlined in a statement by the Chairman of the National Advisory Council given to the House Committee on Banking and Currency on July 24, 1946. In this statement, the Chairman referred to a request of President Roxas for credits aggregating approximately \$400 million to cover anticipated budgetary deficits over the next five years. He stated that it was the feeling of the National Advisory Council that a broad program of this magnitude should not be undertaken before study had been made of the facts and of possible alternative solutions of this problem. He commented that it would be unfortunate if the Philippine Republic were to be unnecessarily saddled with an external debt of this size. He indicated that among the topics the Commission might explore were "measures which might be taken to mobilize and utilize the existing resources of the Philippines."

IV. Relevant Factors in the Philippine Financial Situation

The Chairman of the National Advisory Council expressed the views outlined in Paragraph III above because, in addition to the need for further information concerning the current Philippine situation, the National Advisory Council was strongly of the opinion that the Philippine Government can take a wide variety of measures to increase its revenues and otherwise make better use of its own resources. It felt such measures might to a substantial degree obviate any real need for foreign credits in addition to those now authorized. It also believed that the granting of credits as initially requested by the Philippine Government in May, 1946, would remove incentives for taking these measures. This opinion has already been partially confirmed by subsequent developments. It may be recalled that in a letter to Secretary of the Treasury Snyder dated June 26, 1946, President Roxas stated that \$100 million would be needed to cover Philippine budgetary deficits during fiscal 1947, and that on June 30, 1946, his government would be practically without funds except for currency reserves. It subsequently appeared that on a cash basis the Philippine Government's need for additional funds to cover budgetary deficits did not arise until toward the end of the year. It further becomes evident that the Philippine Government, in all probability, will not require the full amount of the Reconstruction Finance Corporation credit of \$75 million which Congress has authorized to be extended during fiscal 1947. This development may be attributed to steps which the Philippine Government has taken recently to increase its tax receipts and to finance a substantial rehabilitation program previously included in its 1947 budget, through the newly created Philippine Rehabilitation Finance Corporation.

- 3 -

This Corporation is being financed with receipts from the sales of surplus property and with monetary reserves judged to be in excess of legal requirements on account of loss or destruction of currency during the war. Accordingly, President Roxas has indicated that he does not anticipate an immediate need for pressing the application now on file with the Export-Import Bank for a \$250 million credit.

Encouraging as these developments are, no fundamental approach to the Philippine financial problem, as envisaged by the National Advisory Council has as yet been taken. Such an approach would involve consideration of such measures as a thorough overhauling of the tax system and its administration; budgetary reforms; development of an internal market for Philippine Government securities (direct or guaranteed); possibly the establishment of a central bank, or some other approach to a modernization of the currency system; and economic policies and administrative measures designed to achieve the most effective use of the Philippines' foreign exchange resources for internal reconstruction and development.

V. Structure and Operation of the Commission

It has been decided between the two Governments that the Commission will comprise three American and three Philippine members with one American and one Philippine member acting as Co-Chairman. It is hoped that the Commission will produce a report signed by both American and Philippine members embodying findings and recommendations of the Commission and its staff which will be available to officials of both Governments. However, since the Commission has been constituted on the part of the U. S. Government at the initiation of the NAC, the American members of the Commission should be advised formally by the NAC on what procedures to follow in reporting to the U. S. Government.

In order to clarify the status of the American members they might appropriately be advised by the NAC that they are responsible to the President and Congress through the NAC.

VI. Conclusion

The Staff Committee believes that the American members of the Commission should have the benefit of such guidance as the National Advisory Council can provide at this time in the form of a statement outlining the broad objectives which the Council thinks the American members should seek to achieve.

- 4 -

VII. Recommendation

The following action is recommended to the Council for its consideration:

The National Advisory Council adopts the following statement for the guidance of the American members of the American-Philippine Financial Commission:

The American members of the American-Philippine Financial Commission should aim at the adoption by the Commission of recommendations which will outline a financial, monetary, fiscal, and trade program designed to facilitate the achievement of economic rehabilitation and recovery in the Philippines, and particularly the institution of sound and efficient governmental financial policies and practices. In considering the various methods for achieving these objectives, the American members should give preferred attention to those which would effectively maximize the contribution of Philippine resources and minimize the dependence on additional foreign credits.

The National Advisory Council considers that in implementing a sound rehabilitation and development program it would be unwise for the Philippine Government to contract foreign obligations larger than those absolutely necessary to supplement its own internal resources. In particular, these obligations should not be so large as to impose too severe a drain on the future Philippine balance of payments.

As to the specific measures to which attention should be given, the National Advisory Council does not desire to limit the broad range or scope of the Commission's field of investigation as proposed to and accepted by the Philippine Government. The National Advisory Council does desire, however, that specific and detailed attention be given to certain problems with a view to recommending measures to produce additional revenue and achieve the most effective use of the Philippine Government's actual and potential financial resources. These are listed below:

1. Tax reform, particularly the possibility of increasing the rates of existing tax laws, adopting new tax measures, and enforcing all tax laws more effectively.
2. Budget, particularly the possibility of adopting administrative measures to increase governmental efficiency, and of reducing expenditures for non-essential purposes.

- 5 -

3. Public debt, particularly the future possibilities of floating internal loans, including indirect (guaranteed) obligations of the Philippine Government.

4. Banking reform, particularly the possibilities of employing existing banking facilities more effectively in promoting economic recovery and of taking steps toward the establishment of a central banking system.

5. Monetary reform, particularly the possibility of freeing such part of the present currency reserves as might be considered excess to an adequate margin of safety.

6. Trade and exchange problems, particularly the possibility of taking measures to achieve the most effective use of actual and potential foreign exchange resources for internal reconstruction and development.

It is desirable that the Commission's report be available to the U. S. Congress at the earliest possible date. It is therefore requested that it be submitted to the National Advisory Council not later than May 1, 1947.

The American members of the Commission are responsible to the U. S. Government directly, through the NAC. They are instructed that the report or reports produced by the Commission should be addressed to the President of the United States and transmitted through the NAC.

The Council approves the transmittal of a copy of NAC Document No. 315 to the American Co-Chairman of the American-Philippine Finance Commission.