BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 26, 1947

To Chairman Eccles

Subject:

From Mr. Knapp

The attached memorandum contains a report on the progress (or lack of progress) in the thinking which is going on in the Administration and in the International Bank concerning the division of functions in the European Recovery Program between the International Bank, the Export-Import Bank, and the new "Marshall Plan" agency (which it is assumed will also have lending powers). At present there is great confusion on this subject, and it seems to me that the only way to resolve the confusion is to have the National Advisory Council Staff Committee prepare a report on the matter for consideration and decision by the N.A.C. If you agree with this proposal, I shall take steps to implement it.

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

SECRET

Office Correspondence

Date November 25, 1947

To Chairman Eccles

From Mr. Knapp

Subject: Meeting held in the International Bank to discuss the question of the role of the Bank in the Marshall Program.

A meeting was held in the International Bank this morning to discuss the question of the role of the Bank in the Marshall Program. Among those present were Mr. McCloy, Mr. Garner, and Mr. Black, several members of the Bank's staff, and staff representatives from the State, Treasury and Commerce Departments.

The discussion was quite inconclusive. It was pointed out that in the documentation which is to be presented to Congress in connection with the "Marshall Plan" an estimate is presented that the International Bank (plus the private capital market) will be able to finance 500 million dollars of the European dollar deficit in the first full year of the Program, and about 2 billion dollars over the four-year period (the Paris Report had suggested that the International Bank and private capital market cover over 3 billion dollars, this being the amount of European capital equipment needs exclusive of agriculture and mining machinery). The International Bank people, although apparently feeling that these estimates were on the high side, did not object to them provided that they were not presented as firm figures.

Most of the ensuing discussion consisted of an exchange of ideas concerning the type of loans that the International Bank might make under the Marshall Program and concerning the ways in which the Bank's lending activities might be coordinated with those of the new "Marshall Plan" agency and the Export-Import Bank.

With respect to the first point, Mr. Garner initially made a flat statement that the International Bank should make loans only to finance large-scale capital installations (the "special project" idea in its purest form), and of course also insisted that the credit risk must be good. There was general agreement with the latter point (no one is trying to press the Bank to make loans to dubious credit risks). With regard to the former point, however, I expressed the view that such a narrow limitation would unnecessarily hamper the Bank's lending program and would necessitate its turning down loan applications from perfectly good borrowers just because they could not offer the proper kind of "show piece". Mr. McCloy supported this point of view to some extent, but he too felt that the Bank should not get into the business of general balance of payments loans but should confine itself to fairly concrete and definable programs. I believe that in almost every case a prospective borrower could pick out of its import program a particular set of imports which would satisfy Mr. McCloy's concepts.

With regard to coordination among the various lending agencies, it was pointed out that the National Advisory Council would presumably carry out this function. However, Gene Black felt (I think, correctly) that there would have to be regular direct contact among the agencies involved, and at one point he suggested that this might be formalized as a special committee which would consider special coordination problems before they were referred to the National Advisory Council. Mr. Garner was worried that if the N.A.C. reviewed a loan application and decided that it should be referred to the International Bank, this decision might prejudge the Bank's consideration of the application. He seemed reassured, however, when it was pointed out that the N.A.C. would only refer the loan to the International Bank "for consideration".

Reference was then made to the difficulty which would arise if lending agencies of the U.S. Government (the new "Marshall Plan" agency or the Export-Import Bank) were making loans to the European countries at interest rates below that applicable to International Bank loans (at present 4-1/4 per cent). It was pointed out that this would lead prospective borrowers to approach the U.S. Government first and to resist being passed on to the International Bank. It was also asserted that it would be illogical to force the better credit risks to pay the higher rates charged by the International Bank while the inferior credit risks which would have to be handled by the U.S. Government would get lower rates. This led to the suggestion that the U.S. Government lending agencies might raise their interest rates to the level of the International Bank's rate.

There seemed to be general agreement that this latter suggestion was impracticable. Furthermore, I pointed out that the payment of higher interest rates by the better credit risks could be justified on the grounds of ability to pay; in other words, the inferior credit risk countries would be granted the lower interest rates applied by U.S. Government agencies just because they were incapable of bearing the burden of ordinary commercial rates. This rationalization was not satisfactory to many of those present, but no other solution was offered to the problem.

Reference was also made in the discussion to the indirect support which the International Bank might give to the European Recovery Program by making loans to "non-Marshall Plan" countries, either to promote the output of commodities for export to Europe or, in a more general way, to meet their dollar requirements so that they might be in a position to make loans to European countries. Mention was made of the special case of Poland where the Bank might finance the expansion of coal production which would flow to Western Europe; however, the Bank's officers were very reticent on this matter. There was more discussion of the Bank's possible role in Latin America, and Mr. McCloy emphasized that in the Bank's view loans to develop the "natural flow" of exports from Latin America to Europe would be highly desirable and much more useful than loans to finance industrialization projects in that area.

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The question naturally arose in this discussion of what role the Export-Import Bank would play in the Marshall Program, but no one was prepared to answer this question in any definite way. The same subject came up at a meeting of the "Advisory Steering Committee" for the European Recovery Program which I attended later in the afternoon. At this meeting the State Department proposed including in one of the documents which is to go before the Congress in connection with the "Marshall Plan" a statement that the Administrator of the new "Marshall Plan" agency might use the Export-Import Bank as his agent in making loans to European countries. However, Bill Martin had got advance notice of this proposal and appeared at the Committee meeting to urge that this passage be deleted since the Bank had not yet made up its mind as to the desirability of such a procedure. This was agreed by the Committee, although we were subsequently informed that the author of the initial proposal was none other than Willard Thorp.

As you will see, therefore, there is considerable confusion as to the role of the Export-Import Bank. I understand that the prevailing view in the Export-Import Bank is that the Bank should have nothing to do with the European Recovery Program and that any loans which are to be made in connection with such Program should be made by the new agency. According to this view, the Export-Import Bank should concentrate its activities upon other areas of the world, and engage mostly in medium-term financing as contrasted with the long-term financing of development projects to be handled by the International Bank. In general I find myself in agreement with this view, since I think it would be unnecessarily confusing and complicated to have two U.S. Government agencies making loans to European countries under the Marshall Program. However, both the Harriman and Herter Committees have proposed that the Export-Import Bank should engage in the European Recovery Program specifically for the purpose of financing raw material requirements. This position is based upon the completely illogical view that the financing of raw materials should be carried out on a medium-term loan basis. My comment on this is that raw materials may have to go to some countries as grants, if those countries are unable to assume the burden of repayment, and that where countries can assume the burden of repayment there is no good reason why the International Bank could not handle the loans, either on a medium-term or long-term basis.