SECRET

April 21, 1948

Chairman McCabe — Agenda for today's National

Mr. Knapp — Advisory Council meeting

Attached is a copy of the agenda for this afternoon's National Advisory Council meeting.

Please note that the matter of ERP allocations is not formally listed as an item on the agenda, but the paper which we discussed yesterday will be presented for the information of the Council under "Other Business". As of last night Secretary Snyder had not yet talked to Mr. Hoffman, and it is still not known whether there will be any discussion of the procedural problem involved in these allocations. Incidentally, I am attaching for your information a copy of the minutes of the NAC discussion of this subject last month (please note that these minutes, and all NAC minutes, are classified TOP SECRET).

With respect to Item 2 on the agenda, "Proposed terms of payment on ECA loans", there is attached the report by the Staff Committee on this subject which was not available in time for our meeting yesterday morning. Please note that subsection (d) in the second paragraph, which gave us some trouble yesterday morning, has now been slightly redrafted by the Treasury. Their redraft seems to me to be an improvement, and I think it will be acceptable to you.

Two new items have been added to the agenda. The first, listed as Item 3, "Application of Iceland for $2.3 million credit", relates to an application by Iceland to the Export-Import Bank for a 2.3 million dollar credit for the purchase of a fishing vessel and related equipment. Since Iceland is an ERP country, the Staff Committee feels that this credit ought to be handled by the Administrator if possible; on the other hand, it appears that the purchase of this ship is a matter of some urgency so that if the Administrator is not prepared to handle it right away action by the Export-Import Bank would seem appropriate. The Staff Committee is therefore recommending the following action:

> "The National Advisory Council approves consideration by the Administrator for Economic Cooperation of credits to the Government of Iceland in an amount up to $2.3 million. If the Administrator for Economic Cooperation does not find it feasible at this time to extend these credits the National Advisory Council approves consideration by the Export-Import Bank of credits to the Government of Iceland in an amount up to $2.3 million."

A further item which will be raised for discussion under the heading "Other Business" relates to a proposed credit of 26 million dollars to Iran for the purchase of surplus military equipment. I am attaching a separate memorandum on this subject.

Attachments
JBK:mla

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NATIONAL ADVISORY COUNCIL
ON
INTERNATIONAL MONETARY AND FINANCIAL PROBLEMS

Agenda
Meeting No. 93
Wednesday, April 21, 1948
4:00 p.m., Room 4426, Main Treasury

1. Appropriation request for economic rehabilitation of Japan
   (NAC Document No. 654 - previously distributed;
   NAC Document No. 642 - previously distributed;
   NAC Staff Document No. 214 - previously distributed)

2. Proposed Terms of payment on ECA loans
   (NAC Document No. 665 - previously distributed;
   NAC Document No. 668 - to be distributed)

3. Application of Iceland for $2.3 million credit
   (NAC Document No. 640 - previously distributed;
   Draft Action - to be distributed)

4. Bank for International Settlements
   (NAC Document No. 661 - previously distributed)

5. Other Business

John W. Gunter
Secretary

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National Advisory Council
Document No. 665
April 20, 1948

MEMORANDUM To: National Advisory Council

From: National Advisory Council Staff Committee

Subject: Proposed Terms of Payment on ECA Loans

1. Problem

The Administrator, in accordance with the Economic Cooperation Act of 1948, has requested the advice of the National Advisory Council, on terms of payment on loans to participating countries.

2. Background

(a) United States Government Loans and Credits. Considerable variation has existed in the terms of payment on loans and credits extended by the United States Government in recent years. Some general principles, however, can be stated. All the longer-term credits have called for amortization of the entire principal sum by regular annual or semiannual payments. In some cases the amortization of principal has not been scheduled to begin immediately but only after a period of several years (in the following discussion, such an initial period of deferment is referred to as a "period of grace"). Interest payments have ordinarily begun from the date the loan or credit was extended, or from the date that it was disbursed or utilized, even where there has been a "period of grace" for the amortization of principal; the only important exception to this rule has been in the Anglo-American Financial Agreement, where interest does not begin to accrue until about five years after the date of the loan.

The following summary indicates the terms of each of the principal U.S. Government loans and credits.

Lend-Lease (3-C Agreements)

Final maturity 30 years, no period of grace, interest rate of 2-3/8 percent per annum.

War Settlements Arrangements

Final maturity 35 years including a 5-year period of grace on repayments of principal, interest rate of 2 percent per annum, provision that payments of interest and/or principal may be postponed if both parties agree that because of extraordinary and adverse economic conditions arising during the course of payment any periodic payment would not be to the common advantage of both governments.

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Export-Import Bank Loans

(1) Loans to finance export of goods for which requisitions were filed by foreign governments under Lend-Lease. - Final maturity 30 years, no period of grace, interest rate of 2-3/8 percent per annum.

(2) Reconstruction loans. - Final maturity 20-30 years, periods of grace of about 5 years, interest rate of 3 percent per annum.

(3) Development loans. - Final maturity up to 20 years (depending on nature of project), periods of grace in some cases, interest rate of 3-1/2 percent per annum.

(4) Various other loans and credits at varying maturities and interest rates according to the nature of the commodity and the transactions.

Anglo-American Financial Agreement

Final maturity 55 years, including a 5-year period of grace applying to both interest and amortization, interest rate of 2 percent per annum, and allowance for waiver of interest under certain conditions.

Office of Foreign Liquidation Commissioner Credits

Final maturity not more than 30 years, with postponement of first amortization payments for 5 years if necessary, and interest rate of not less than 2-3/8 percent per annum.

Reconstruction Finance Corporation (Philippine Loan)

Maturities approximately 5 and 6 years, no amortization, interest rate of 2 percent per annum.

War Assets Administration Credits

(1) For war-devastated countries. - Payments over a period of 15 years, including a 2-year period of grace on repayments of principal, at an interest rate of 3 percent per annum.

(2) For non-war-devastated countries. - Payments over a period of 10 years or less, including a 2-year period of grace on repayments of principal, at an interest rate of 3-1/2 percent per annum.

(3) Items subject to statutory limitations, i.e., raw materials, consumer goods, small tools, hardware and non-assembled articles which may be used in the manufacture of more than one type of product. Payment in 3 years, no amortization, interest rates as above.

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(b) International Bank Loans. The International Bank has made loans to five countries with terms as follows:

(1) France: Loan for a period of 30 years with amortization over a 25-year period beginning 1952, interest rate (from date of disbursement) 3-1/4 percent per annum plus a commission of 1 percent per annum, commitment charge from date of commitment to disbursement at rate of 1-1/2 percent per annum. Amortization schedule arranged so as to permit smaller payments of principal in the earlier years than in the later years.

(2) The Netherlands: Loan for a period of 25 years with amortization beginning in 1952; interest rates same as for France.

(3) Denmark: Loan for a period of 25 years, with a 6-year period of grace on repayments of principal, interest rates same as for France.

(4) Luxembourg: Loan for a period of 25 years, with a 2-year period of grace on repayments of principal, interest rates same as for France.

(5) Chile: Two loans: $13.5 million for a term of 20 years, amortization payments to begin in the sixth year, with interest rate of 3-1/2 percent per annum plus 1 percent commission per annum; $2.5 million for a term of 6-1/2 years, amortization payments to begin in the third year, with interest at the rate of 2-3/4 percent per annum plus a commission of 1 percent per annum. Commitment charge 1-1/2 percent per annum but increasing on amounts undisbursed after six months.

(c) Private Capital Financing. Financing in the United States private capital market by the participating countries has, in the post-war period, been extremely limited. In April 1947, Norway sold $10 million of 3-1/2 percent 10-year bonds at 98-1/2, and in May 1947 the Netherlands sold $20 million of 3-3/4 percent 10-year bonds at 99. Recent quotations for these issues have indicated a considerable decline from the original issue price.

3. Discussion

(a) Uniformity.

As a general principle, the terms of payment on loans (including maturity, period of grace, rates of interest, etc) should be uniform among participating countries. Serious administrative difficulties, as well as political hazards, would be involved in drawing

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distinctions between recipient countries on the basis of the risk involved, urgency of need, or ability to repay. Differences in credit worthiness can be taken account of in practice only in decisions whether to lend or not to lend, or whether to lend more or less. An evaluation of this type has already been expressed in the percentage divisions between loans and grants recently recommended to the Administrator by the Council.

Application of the principle of uniformity, however, need not preclude varying the terms of different loans to any one country, provided the annual debt burden assumed by each country is generally not greater than would result from the uniform terms. For example, if a uniform maturity of 30 years were considered as reasonable, there would appear to be no objection to extending some loans for a shorter period if they were offset by other loans to the same country that would be for longer than 30 years (or would be for 30 years but would call for lower rates of amortization in the earlier years and higher rates in the later years). Likewise, some of the loans might bear interest rate lower than the standard rate if they were offset by others bearing higher than the standard rate. In this way, the annual burden on the balance of payments of the recipient country could be made about the same as if all loans had been extended for 30 years and at the standard rate of interest. This would provide a desirable degree of flexibility in the Administrator's operations without inviting the charge of unwarranted discrimination among participating countries.

Where loans are made to countries that will also be receiving grants, a special case can be made for setting the terms of loans on a liberal basis (i.e. very low rates of interest and amortization), in order to maximize the amount of the assistance to each country that can be placed on a loan basis. Then, the lower the interest rate and the longer the period of amortization (and hence the lower the annual service charge per million dollars of loans) the greater will be the amount of assistance that can be given in the form of loans. Furthermore, once the amount that the country can pay annually has been determined, it is obvious the longer such payments are kept up the larger will be the total amount that the United States recovers, although there should be some reasonable limitation on the duration of the repayment period so as to avoid appearing to create a perpetual indebtedness.

If the loans to some recipient country were to be given on terms calling for more rapid amortization, thus increasing the annual charge per million dollars, the effect would be to reduce the total amount of loans that the country could service. It would thus necessitate that more of that country's assistance be placed on a grant basis than would otherwise have been the case, and would reduce the total amount of repayments that the United States could collect.

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The analysis would be somewhat different with respect to countries receiving all their assistance on a loan basis. When a country is put in the "all loan" category, this will reflect a finding that that country's long-term ability to repay would support an amount of loans greater than (or, at least, equal to) the amount of assistance needed under the program. For such countries, it might be possible to shorten the period of amortization and still keep the annual service charge within the country's ability to repay.

(b) Maturities.

The Council has recognized the appropriateness of long maturities in conjunction with loans and credits extended for reconstruction purposes. (For example, loans under Lend-Lease 3-C Agreements and OFLC credits have had maturities of 30 years, War Settlements arrangements have involved maturities of 35 years, and the Anglo-American Financial Agreement has a maturity of 55 years.) The foreign policy of the United States and the economic welfare of this country require that the terms of foreign loans be such that the borrowing countries can be expected to meet them without undue burden on their balances of payments. Where the maturity of a loan is for an extended period, so that the annual rate of amortization is low, the likelihood of default is reduced.

It was the concensus of the Staff Committee that maturities of approximately 30 years would be appropriate for this purpose.

The useful life of the goods received by the participating countries can not serve as the criterion for determining the maturities of ERP loans. While under other circumstances it is often desirable that the maturity of a loan to finance an equipment purchase should fit the life of the equipment, the special circumstances of ERP loans would make this standard unsuitable for general application to them. This is true because a country receiving equipment items on a loan basis may also be receiving other items on a grant basis, and if the loans to pay for these equipment items had to be amortized in full within the life of the equipment, this would reduce the country's ability to make payments on other loans and hence would increase the amount of other items that we would have to furnish on a grant instead of a loan basis. Furthermore, imports of food, feed and fertilizer will, to certain countries, be as significant reconstruction items as will imports of capital equipment to other countries.

In the last analysis the repayment of ERP loans, like other loans to governments, depends mainly on the general debt-paying ability of the borrowing government, rather than on the productiveness of the particular project or program that the loans financed.

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(c) Period of Grace.

The term "period of grace" is used here to refer to a period that is to elapse between the date when a loan is made and the date when repayments are to begin. Such periods of grace have not been uncommon in long-term United States Government loans and credits. The War Settlements arrangements include a 5 year period of grace on repayments of principal, OFLC credits may permit the postponement of first amortization payments for 5 years, WAA credits characteristically include a 2 year period of grace on amortization payments and the Anglo-American Financial Agreement has a 5 year period of grace with respect to both principal and interest payments.

It would not appear appropriate to require repayment of principal during the period of the European Recovery Program as now conceived. (Current deficits of recipient countries would be increased by amortization payments, and the result might be that in effect repayments would be made out of ERP funds.) The Staff Committee is therefore of the opinion that amortization of principal might be deferred for 5 years after individual loan contracts have been signed with participating countries. The period of grace would be included in the 30-year maturity period discussed in the preceding section.

(d) Interest Rate.

The Staff Committee is in agreement that the rate of interest to be charged by the Administrator should be sufficient to cover the cost of money to the United States Government. The cost of money to the Government should be based on the average of both long-term and short-term issues, weighted according to the prospective proportions that will be outstanding, since the terms of Government borrowing is independent of the specific purposes for which the funds are used. Since there is no basis for estimating changes from the present proportions over a period of years, the only practical procedure is to assume that the present distribution of long and short-term debt will continue. The present cost of money to this Government is slightly less than 2-1/4 percent per annum. On the other hand the going rates for long-term Export-Import Bank credits and International Bank loans are 3-1/2 - 4-1/2 percent per annum.

The Staff Committee felt that, in view of the general objectives of the European Recovery Program and the desirability of extending liberal terms to recipient countries, a rate of interest of 3 percent would be appropriate. Also, for psychological reasons, if the interest rate is kept low so that the largest possible amount of repayments is labeled as principal rather than interest, the total amount collected by this country may be maximized. This latter point is really applicable only where a country is to receive partly grants

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and partly loans, so that the amount of the country's annual payments depends on its estimated ability to repay rather than on the amount of assistance that it receives.

If the final maturity of a loan is 30 years, including an initial grace period of 5 years (making a 25 year period of amortization) and if the rate of interest on unpaid balances is 3 percent per annum, then the annual service (covering both interest and amortization) during the 25 year period would be 5.74 percent per annum.

(e) Postponement of payments.

The Staff Committee considered the question of whether there should be included among the terms of the loan contract some provision for the postponement or waiver of interest and/or principal along the lines of (1) the provision in the Anglo-American Financial Agreement for waiver of interest in periods when British exports fall below a specified level, (2) the provision in War Settlements agreements that if both countries agree that because of extraordinary and adverse economic conditions arising during the course of payment any periodic payment would not be to the common advantage of both governments, such payment might be postponed upon such terms and conditions as might be agreed, or (3) the provision in the International Bank's Articles of Agreement that the Bank may "accept service payments on the loan in the members currency for periods not to exceed 3 years."

The Staff Committee felt that consideration should be given to inclusion of a postponement provision similar to that in the War Settlements agreements in the loan contract. Such a clause might avoid the necessity of outright default in case of future general balance of payments difficulties and thus increase the possibilities of eventual repayment.

4. Recommendation

The following recommendation is submitted for the consideration of the Council:

> The Council recommends that in principle the terms of payment on ECA loans be in general conformity with the terms of loans by the Export-Import Bank under its 1945 Act, with due regard to the character and purpose of the loans approved by the Economic Cooperation Administration.

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The Council recommends that the Administrator in arriving at the terms of payment of such loans consider the following:

(a) that, other things being equal, the terms of payment should be uniform among participating countries;

(b) that the typical final maturity should be long, i.e., in the neighborhood of 30 years, with amortization of principal beginning 5 years after the date of the loan;

(c) that the rate of interest should normally not exceed 3 percent per annum;

(d) that variations of the terms of any individual loan from the typical or normal terms should not be precluded:

(i) so long as the aggregate annual burden of debt assumed by the borrowing country is not substantially changed from that which would result from general application of the normal terms, or

(ii) where the borrowing country appears able to pay within a shorter period for all assistance received;

(e) that, although it would be desirable for loans of particular maturities to be assigned, where possible, to suitable commodities or projects; the serious nature of the balance of payments deficits giving rise to this program commends the use of great caution in varying the terms of loans by reason of the nature of the commodity or project.

(f) that consideration be given to the question of including in the loan contracts a provision for postponement of payment or modification of service charges in periods of unanticipated balance of payments stringency.

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