SECRET

Governor Eccles

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Chairman McCabe

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National Advisory Council meeting tomorrow.

Following are comments concerning the subjects on the agenda for tomorrow's NAC meeting:

1. International Bank loan to Netherlands shipping companies

The International Bank proposes to lend $12 million to enable Dutch shipping companies to buy six cargo ships in the United States. The notes of the shipping companies will be guaranteed by the Netherlands Government.

The Dutch need these ships, and it is to the interest of the United States that they should have them. Furthermore, the ships will earn foreign exchange so that the service on the loan will not be an added burden on the Dutch foreign exchange resources. For all these reasons the Staff Committee has agreed that the loan seems entirely sound and that the Council should advise the United States Executive Director to favor it.

The International Bank also proposes to attach its guaranty to the shipping companies' notes and then to sell to U. S. commercial banks the $6 million of notes that mature within five years. The Bank may also sell the remaining $6 million, maturing in 5-1/2 to 10 years, if it can find purchasers. This will represent the Bank's first use of its guaranteeing powers. It should be observed, however, that the 2-1/2 per cent rate which commercial banks will receive on these guaranteed notes is considerably higher than the yield basis on which the Bank's 2-1/4 per cent bonds due in 1957 are now selling on the open market. Thus it seems to me very questionable whether the sale of guaranteed notes on this basis is really advantageous to the Bank. The Bank's principal source of funds is likely to be through bond sales rather than through commercial bank loans, and the sale of these notes on a yield basis so much higher than that of the Bank's bonds may add to the difficulty of placing future bond issues. However, this is a matter peculiarly within the discretion of the Bank's management, and would not be a ground for Council objection to the proposed sales.

2. Exchange rates to be used in local currency accounts

Countries that receive ECA grants are to deposit equivalent amounts of their local currencies in special accounts. Where these countries have rates of exchange agreed with the International Monetary Fund, those rates will be applied in determining how much local currency should be deposited for each dollar's worth of goods received as grants. Five of the countries, however, do not have agreed rates; for such cases, the draft bilateral agreement provides that the rate to be used shall be determined by the U. S. Government in consultation with the recipient country. The NAC is now asked to advise the Administrator on the determination of these rates.

Three of the countries involved (Austria, Greece and Italy) have single effective rates of exchange for the dollar, and it seems clear that these rates should be used.

The case of France is somewhat complicated. In order to keep down the domestic prices of certain "basic" commodities, French importers of these commodities have been permitted to buy dollars at 119 or 214 francs to the dollar, while importers of other commodities from the dollar area purchase their dollars at about 260 francs to the dollar. The Staff Committee recommends that France be required to make deposits in the special account at the 260 rate. The French are likely to urge very strongly that deposits be permitted at the 214 rate where a grant covers basic commodities on which importers would be permitted to buy dollars at rates of 214 or less. They will point out that the requirement of deposits at the 260 rate would require that they either (a) raise their internal prices correspondingly or (b) find ways of raising revenues to enable them to deposit more francs in the account than they receive from the sale of the goods. On the other hand, if the U. S. were to permit the use of the 214 rate, it might be regarded as the giving of a special rate in order to assist the recipient country in selling the imported goods internally at a subsidized price. We should not want to give such a concession to France, merely because its subsidy is involved in a system of multiple exchange rates, while we would certainly not be prepared to permit other countries to draw funds from their special accounts to finance domestic subsidy programs.

For China, a special problem arises because of the chaotic exchange situation in that country. The Staff Committee agreed that for the present it would be reasonable to use the same exchange rate that was agreed with the Chinese in December 1947 for purchases of Chinese currency by U. S. Government agencies. This is a rate derived from the free market rates quoted in the Hong Kong market.

3. <u>The problem of financing intra-European trade</u>

One of Europe's most difficult financial problems at present is the problem of developing a suitable mechanism for financing trade among European countries. Because of the difficult foreign exchange situations facing most of these countries, trade among them is now almost entirely confined to trade which is covered by bilateral agreements. Hence, sales by Country A to Country B cannot exceed the amount of sales from Country B to Country A, except to the extent that Country A is willing to extend credit or Country B is willing to deplete its foreign exchange reserves. There seems to be unanimous agreement both in this country and in Europe that the development of multilateral trade among European countries is a vital factor in the success of the recovery program.

The ECA Administrator has now asked the Council's advice regarding a plan to use special local currency accounts to assist in meeting this problem.

The problem of reviving multilateral trade may be divided into two parts:

(1) The setting up of some sort of multilateral clearing system whereby a country can use the proceeds of its sales to one country to pay for purchases from another, and

(2) The making of some arrangement for the settling of net balances -- i.e. of the net amounts by which a country's total exports to all the others in the group are greater or less than its imports from the others in the group.

The participating countries in Europe recently set up a multilateral clearing system which is managed for them by the Bank for International Settlements, but up to the present, the results achieved by this system have been small, due largely to the fact that the system is not yet accompanied by any satisfactory arrangement for the settling of net balances.

It is extremely important that a plan for settling the net balances be developed along lines that will give to each participating country a substantial incentive to expand its exports to other countries in the group. Since the war, much of the trade within Europe has been financed by the extension of credit from the selling to the purchasing country. In most cases the outstanding amounts of such credits have reached the limits that the creditor countries are able or willing to extend, or are approaching such limits. Because the creditor countries in Europe themselves face the problem of financing imports that they need from the Western Hemisphere, they are naturally reluctant to devote their resources to exporting goods where they have to sell on credit instead of for spendable currencies.

Several of the proposed solutions that have been under discussion would provide that where a country's trade with the rest of Europe results in a net balance due to it from other European countries, it should be able to obtain U. S. dollars from the International Monetary Fund for part of this net balance provided that it extends credits (or, under some plans, grants) for the remainder. These are among the possibilities that are being studied and analyzed by the NAC Staff Committee. The Staff Committee is concerned that any plan adopted should give adequate promise of fulfilling its objective <u>without</u> resulting in such large drafts on the Monetary Fund as to impair the future usefulness of the Fund. The Staff Committee is exploring the wayx in which an appropriate arrangement of "off-shore purchases" by the ECA Administrator within Europe might contribute substantially to the meeting of this problem. I hope that within the next week or two the Staff Committee will be in a position to put forth proposed solutions of this problem for the consideration of the Council.

Meanwhile the Finance Ministers of five countries meeting at Brussels have tentatively advanced a proposal whereby net balances would be met partly by drawing on the Monetary Fund and partly by the use of the local currency accounts that European countries will set up in connection with grants that they receive under the ERP. Under this plan, each country would set aside some stated amount of its currency; then, if that country develops an export surplus within Europe, the part of the balance due to it that is not met by its debtors' drawing on the Monetary Fund would be met by taking funds out of its special account. The debtors would deposit equivalent amounts of their currencies in their special accounts. Since the plan involves the use of funds deposited in special accounts in connection with ECA grants, the plan would of course require the approval of the Administrator. The Administrator has now requested the advice of the NAC on permitting such use of these funds.

The Staff Committee recommends that the Administrator be advised that the Council "perceives no objection in principle to the use of part of the local currency accounts for the purpose of facilitating intra-European trade. The Council believes, however, that the use of local currency for this purpose should not be regarded as a substitute for effective steps, including appropriate financial arrangements among participating countries, designed to facilitate and expand intra-European trade on a multilateral basis."

While this recommendation would meet the Administrator's specific inquiry, it does not provide any real answer to the problem of financing intra-European trade. This is because the two parts of the Brussels proposal involving (a) the use of these local currency accounts, and (b) the use of the Monetary Fund, are really indivisible. The Staff Committee believes that the use of the Monetary Fund in the way envisaged in the Brussels proposal would be distinctly undesirable. Without the use of the Fund, the Brussels group would certainly drop their whole proposal, because it would provide no incentive to develop exports and hence would have no chance of achieving any real results.

I should think, therefore, that the members of the Council might well refrain from taking any action on this subject at this time, preferring to wait until they have before them some action that would be more significant and constructive. However, if the ECA Administrator wants an NAC action now on the single question of using local currency funds to facilitate intra-European trade, I see no real objection to the proposed action.