

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

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To Board of Governors

Subject: The Inter-American Bank

From Mr. Gardner *WTR*

proposal

CONFIDENTIAL

The Board may presently be called upon to express its attitude toward the possible establishment of an Inter-American Bank and to decide whether the Federal Reserve System should participate in the capital and management of such an institution. It would be helpful to those members of the Board's staff who are being consulted in regard to some of the economic questions involved if they could have an indication of the Board's attitude at this stage.

The Inter-American financial sub-committee and the group of Treasury-Board experts

The possibility of establishing an Inter-American Bank has been under discussion in a sub-committee of the Inter-American Financial and Economic Advisory Committee, the latter being composed of representatives of 21 American Republics meeting in Washington. Mr. Sumner Welles, Under Secretary of State, is the American representative both on the main committee and on the financial sub-committee; but Mr. Adolph Berle, Assistant Secretary of State, is serving in his stead on the financial sub-committee. The other members on the financial sub-committee are from Argentina, Mexico, Colombia, Bolivia, Ecuador, and Peru.

At Mr. Berle's request experts of the Treasury and the Federal Reserve Board have met to consider the possible sphere of operations of an Inter-American Bank. The Treasury men involved in the discussions have been Messrs. Stewart, Riefler, Viner, White, Cochran, Bernstein, Glasser, Cotton, Schmidt, and Hanson. From the Board's staff Mr. Goldenweiser and I have attended.

First stage of discussions

At the first meeting of the Board-Treasury group there was general agreement that the sphere of operations would be small for a bank that confined itself to short-term business and took open positions in the various currencies for only limited periods of time. Even as regards longer-term credits the viewpoint was strongly expressed that these would ultimately have to be repaid in goods and that action to open up the United States market to Latin American goods was the realistic approach to the situation.

Following this meeting, most of the members of the group met with Mr. Berle. Mr. Berle stated that discussion within the financial sub-committee was still tentative, but that he was approaching the suggestion of an Inter-American Bank sympathetically not so much because it might prove useful as a financial mechanism, but principally because in the existing world situation it was imperative to foster institutions that would help to bring together the American

Republics. In order to get a better factual basis on which to proceed and to allow time to explore the possibilities of the situation, the experts agreed to prepare a list of questions that Mr. Berle might submit to the financial sub-committee.

The questions were prepared and submitted to the financial sub-committee. Mr. White of the Treasury and I subsequently attended a meeting of the committee in order to assist Mr. Berle in explaining the questions to the Latin American representatives. As a result of this meeting a number of changes were made in the questionnaire and on Friday, December 15, the members of the committee agreed to send it on to their respective Governments for reply.

A possible Inter-American Bank

Meanwhile the Treasury and Board experts had been working on an outline of a possible Inter-American Bank in order to clarify thinking on the subject. While thought was far from crystallized, there appeared to be general agreement that the business of the Bank, if there was to be one, should occupy a preferred position. That is, the Bank should be given a blanket guarantee by all the Governments concerned against the blocking of its assets through exchange control or similar restrictions. In this way the Bank's business would not only be rendered more secure, but it would break a hole in the network of currency restrictions; and this hole might be widened as the Bank's

business developed. If it was to develop an adequate sphere of operations it seemed evident that the Bank would have to engage in long- as well as short-term business. The consensus of opinion was that the short-term business of the Bank should be confined to Treasury obligations or paper endorsed by central banks, and that its long-term business should be confined to Government obligations, direct or guaranteed. Thus all the operations of the Bank would be secured by a central bank or Government and would be free of exchange restrictions. It would occupy a relatively safe, yet adequate, field within which it could operate unimpeded.

The funds of the Bank would come from subscriptions to its capital, from deposits (on which the Bank could pay interest), and from sale of the Bank's own debentures. Whether the original subscriptions of capital and the management of the Bank should be by central banks or treasuries or a combination of the two is a question that was left open at this stage. There was, however, general agreement that, broadly speaking, the United States should not contribute more than half the capital nor have more than a third of the control of the Bank. It would be preferable to keep the relative contribution of capital by the United States and the relative degree of control the same. The more capital that could be raised from Latin American countries the better. All 21 countries would presumably contribute. Representation on the board of directors, however,

would have to be reduced through grouping countries or through some other device in order to get a workable operating board.

Deposits in the Bank could be made by anyone. Special deposits by treasuries or central banks might be necessary at the outset, but it was hoped that the Bank and its branches might become, by reason of its preferred position, a popular repository for Latin American funds.

It was also hoped that debentures of the Bank would become popular in Latin American countries as a standard instrument issued by an institution free of exchange control. They might well be preferred over purely national Treasury obligations or mortgage bonds for which markets already exist in a center like Buenos Aires; and given time they might sell in the United States. Special purchases by the Export-Import Bank or the R. F. C. might be necessary, however, until a private market for the Bank's debentures developed. No direct limit would be placed on the issue of debentures, but the earning assets of the Bank would be limited to 10 times its paid-up capital and surplus (thus safeguarding them against a possible 10 percent shrinkage) and the Bank would be prohibited from lending on long-term more than the aggregate of its capital, surplus, and debentures (thus preventing the funds deposited with the Bank from becoming frozen). Later it might be desirable to ease up somewhat on this second restriction.

It was felt that such a bank might in due course engage in a sufficient range of business to earn its expenses and provide a

point of departure for joint consideration of Latin American financial problems. It is evident that any Government coming to the Bank for credit would have to subject its whole present program and past record to the scrutiny of a managing board, including representatives not only of the United States but of Latin American countries as well — particularly those Latin-American countries which had contributed substantially to the capital of the Bank and which therefore would have a stake in prudent lending. If the United States representative was carefully selected ~~both~~ for ability and standing in the financial world, he could exercise an important influence both at board meetings and in going the rounds of the financial centers as he would have to do to keep himself informed. He might well constitute an important liaison between United States finance and the various Latin American centers, assisting to develop solutions of situations that call for action beyond the sphere of the Inter-American Bank.

Major difficulties involved in such a bank

This outline of a possible Bank suggests that thinking on the subject has reached a much greater precision and unanimity than in fact it has. The Bank as described is merely a working hypothesis set up to invite discussion. A great deal of skepticism exists with regard to it. There are at least three major grounds for such skepticism.

In the first place the preferred position of the Bank would depend upon the good faith of Governments in maintaining their guarantee against blockage of the Bank's assets and in paying their contractual obligations. The records of certain Governments are not very encouraging in this respect, nor is there any assurance that in some countries Governments now acting in good faith will not be overthrown and their commitments repudiated. Such an outcome would impose losses on the Bank and would create international embarrassments rather than good will.

In the second place there is the fact already cited that long-term loans of the Bank, in so far as they represent a movement of funds on balance from the United States to Latin America, can be repaid only as goods or services are shipped to the United States directly or indirectly. The problem here is rendered all the greater by the war, for a Latin American export surplus with England can no longer be used to service debts to the United States. The English are requiring the sterling proceeds to be spent in the British Empire or to be used to repatriate Latin American securities now held by the British. Hence the problem of repaying debts to the United States is largely one of finding a market for goods in the United States. Unless this problem is solved, there is danger that the Bank will find itself in a situation in which it can service its dollar loans only by displacing payments to other United States creditors of Latin America.

In the third place there is the problem of administration and personnel. It will be difficult to build up an able and well-coordinated group in view of the political and geographic requirements that would have to be observed. The mere matter of choosing a common meeting place for the managing directors will not be easy. There is danger that really able men will be passed over in favor of men who can more easily be spared for work far removed from the center of things in their own countries. On the other hand, if the United States is ably represented, the Latin American countries will be encouraged to assign their best men to the job.

In view of these various difficulties even those who have been inclined to consider establishment of an Inter-American Bank sympathetically have felt that it should start on a small scale without too large a financial stake on the part of this country. While every effort should be made to keep the institution on a sound basis, this country should be prepared to lose, if necessary, what it puts into the venture. It should regard its contribution as a sort of political insurance with financial possibilities that might, or might not, be realized.

Mr. Riefler's position

Mr. Riefler of the Treasury has expressed his intention of writing a memorandum that will throw all its emphasis on the need for handling the South American problem on a unilateral, rather than a cooperative basis. He is convinced that in the end the United States will have to supply the bulk of the funds and that this fact is inconsistent with a multilateral administration of the funds by many countries. He thinks the administration of such an enterprise would be likely to break down. He would like to keep the reins in the hands of the United States. If he could find a man of the caliber already suggested for the United States director in the Bank, he would send him down as a free lance to Latin America to circulate from country to country and, if possible, bring situations favorable to United States loans to a head through his informal contacts with the financial authorities in both continents. Mr. Riefler has some well-defined ideas as to the sphere in which long-term United States loans might be made; but the field of operations that he has in mind does not differ essentially from that envisaged for the Bank. In fact there appears to be no serious inconsistency in attacking the problem both through Mr. Riefler's free lance financier and through an Inter-American Bank, combining the unilateral and the cooperative method.

Current status

The cooperative aspect of the Bank is precisely what interests Mr. Berle most, and he made this clear to a meeting of the financial sub-committee at the Pan-American Building December 15. At this meeting, which I also attended, Mr. Berle carefully refrained from further developing the United States position; but he did direct the discussion to certain points, one of which was the feasibility of guaranteeing a bank, should some such institution be established, against blocked funds. With the exception of the Argentine representative (whose Government will hardly let him talk) there was immediate and ready assent to the idea.

I understand confidentially that on the same day Mr. White laid the idea of the Bank before the Secretary of the Treasury and that the Secretary wrote Mr. Berle, expressing his general sympathy and suggesting that further exploratory work be done. It is my impression, however, that there still exists a considerable variety of opinion in the Treasury, the State Department, and among Latin American countries as to the advisability of an Inter-American Bank. The most pressing argument in its favor at the moment appears to be political -- the need for cooperative institutions in this hemisphere in the face of disturbing pressures that have become world-wide.

Postscript

This memorandum was finished yesterday and placed in Mr. Goldenweiser's hands. Subsequently Mr. Berle asked me to be present at a meeting of the sub-committee this morning at which certain features of a possible bank were to be discussed. Mr. Cotton of the Treasury was also present. I append a list of propositions which apparently had been worked up by certain Latin American members and which formed the basis of the morning's discussion. They provide for 1) guarantee against blockage of the Bank's assets, 2) location of the Bank's headquarters in Washington, 3) subscription to the Bank's shares by central banks or, where central banks do not exist, by Governments or Government-designated private banks, 4) subscriptions to be equal in amount for all 21 countries, and 5) payment of subscriptions in gold, United States dollars, or paper acceptable to the Governing board.

It was, of course, impossible for me to do more than raise questions and engage in discussion of technical matters. Mr. Cotton of the Treasury endeavored discreetly to get the third proposition changed so as to leave it up to the respective Governments to decide whether their countries should be represented by their central banks or not; but the general sentiment seemed distinctly favorable to central banks as shareholders. The Colombian

representative, for instance, himself a central banker, emphasized the fact that in most Latin American countries the Treasury reflects shifting political forces and personalities and has no banking functions or philosophy. Others confirmed him. On the other hand it was recognized that no central bank could proceed without the approval of its Government, so the question resolved itself into one of establishing a presumption in favor of central banks which Governments would overrule only if they had some positive reason for doing so. The proposition as originally worded was left unchanged. From earlier discussions I know that in this form the proposition harmonizes with Mr. Cotton's personal viewpoint, but I am informed that the Secretary of the Treasury's interest at this stage lies in the direction of a Government institution dealing only with Governments.

There will be another meeting of the sub-committee tomorrow (December 21) which I have been asked to attend.

Propositions discussed at December 20 meeting of the financial sub-committee of the Inter-American Financial and Economic Advisory Committee.

The Inter-American Banking Institution shall enjoy complete autonomy in the fulfillment of its functions; provisions with regard to exchange control or provisions with regard to the control of imports or exports which affect the international movement of capital and which are in force in any of the countries members of the Institution, shall not apply to it nor to operations realized through its intervention; it shall be exempt from any impost or tax established by any of the said countries which directly or indirectly may affect its capital, its profits or its operations.

The Inter-American Banking Institution shall have as its principal seat the City of Washington, and it may establish agencies or branches wherever it may deem expedient.

The shareholders of the Inter-American Banking Institution shall be the Central Banks of the American Countries, where such banks exist; and where they do not exist, the treasuries or the banking institutions designated by the respective Governments.

The capital of the Inter-American Banking Institution shall be formed with the contributions of the member banking institutions, each country contributing an equal amount, such amounts to be fixed when discussing the charter of the Institution.

The contributions shall be paid in gold, United States dollars, or paper or obligations acceptable to the Governing Board.