

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date May 23, 1942

To Chairman Eccles

Subject: Congressional questions on the

From Walter R. Gardner

Inter-American Bank

*WRG*

There is attached a set of comments on half a dozen questions which might come up if Congressional hearings are held on the Inter-American Bank plan. Senator Glass stated in his letter of April 22, 1942, to Under Secretary Welles that it was his intention to hold such hearings at an early date.

Only a few copies of this question-answer sheet have been run off, since I hope to receive suggestions for improvements from those to whom it is being sent.

ANSWERS TO SOME QUESTIONS THAT MAY BE RAISED  
AT CONGRESSIONAL HEARINGS ON THE INTER-AMERICAN BANK

1. What could the Inter-American Bank do that the Export-Import Bank is not now doing?

In his letter of April 22 to Under-Secretary Welles, Senator Glass stated that he had held action on the Inter-American Bank plan in abeyance because Jesse Jones had told him that he was already making all the loans to South American countries that should be made. This raises the question of what rôle the Inter-American Bank might be expected to play that is not already filled by the Export-Import Bank.

The Export-Import Bank has wide powers. It can do a general banking business. It can receive deposits; purchase, sell, and negotiate notes, drafts, bills of exchange, and acceptances; accept bills drawn upon it and issue letters of credit; borrow and lend money; and purchase and sell securities other than shares. It cannot guarantee the availability and rates of exchange of a foreign currency, nor can it guarantee loans; but otherwise its legal powers are almost as broad as those planned for the Inter-American Bank.

The chief difference between the two institutions will be in their ownership and management. The Export-Import Bank is an agency of the U.S. Government. It extends credits to a series of countries, each one of which appears as a borrower making the best case it can for accommodation from the United States. The Inter-American Bank, on the other hand, would be owned jointly by all the participating Governments. Each participating Government would subscribe to its capital and each would be represented on its Board of Directors. A country desiring a loan would submit its case, not to the sole judgment of the United States, but to the representatives of a group of American countries. This group would go into the record of the prospective borrower and appraise the project from the standpoint of its probable effect upon the economy as a whole and upon the ability of the borrowing country to service and repay the loan through its international balance of payments. The fact that the prospective borrower had on other occasions acted in the rôle of creditor and appraised the projects of other countries in the group would be both educative and sobering. And the fact that the loan was being made and collected by American countries as a group should establish a better relationship between lender and borrower than is possible when many countries are dealing with the United States as the sole creditor.

Better  
creditor-  
borrower  
relation-  
ship

Because it is a joint enterprise, the participating Governments will grant the Inter-American Bank an extraordinary degree of immunity from their exchange controls. All funds placed in a country by the Bank may be freely withdrawn at the most favorable rate of exchange being granted by the exchange authorities of that country

Greater  
range  
of opera-  
tion

in any transaction. Hence the Inter-American Bank will have a freedom of movement among the exchange controls of Latin American countries that the Export-Import Bank lacks. If loans mature at a period when the borrowing country is faced with an adverse balance of payments the Inter-American Bank can take payment in local currency, or, what amounts to the same thing, can make local currency deposits in the Central Bank of the borrowing country equivalent to the loan being repaid. These deposits can be withdrawn at the privileged rate of exchange whenever the situation develops to the point at which smooth transfers through the balance of payments become possible. Not only are such stabilizing operations feasible for the Inter-American Bank because of its privileged exchange position, but they should prove far more acceptable to the countries concerned by reason of the international character of the Bank and the fact that these countries are themselves represented on its Board.

Construc-  
tive use  
of Latin  
American  
funds

Again, because of its international character the Inter-American Bank may be able to attract Latin American capital and put it to more constructive use. Standard investment instruments are in general lacking in the Central and South American countries. Local capital tends to find its way into land or special situations. It is possible that debentures of the Inter-American Bank may in time become a popular investment instrument. The Bank may also receive deposits from the public, though it cannot pay interest on such deposits and it is, therefore, unlikely to offer much competition in this sphere to the commercial banks except on funds that might otherwise gravitate to New York. Such local funds as the Inter-American Bank acquires either through deposits or sale of debentures it will be able to reinvest in the country of origin in accordance with a broadly conceived investment program. This type of work within the Latin American countries, turning their own funds to productive use at home, is something which the Export-Import Bank could hardly hope to carry on.

Bankers'  
Club

In short, the Inter-American Bank, by reason of its international character more than because of the scope of its banking and investment powers, can carry out its program in ways which are denied the Export-Import Bank. In doing so it will afford the U.S. director and the U.S. officers of the Bank a notable opportunity to attain an understanding of Inter-American financial problems and to influence the approach to these problems of the leading financiers of Latin America.

In his testimony on May 5, 1941, before a subcommittee of the Committee on Foreign Relations of the Senate to which the Inter-American Bank Convention had been referred, Mr. Clayton, the Deputy Federal Loan Administrator, said "It would be my hope that in time, so far as Latin America is concerned, or let us say any other American republics, the Inter-American Bank would take over the functions of the Export-Import Bank. It will take some time for the bank to do that." Under questioning he repeated the substance of this statement several times.

Continued  
usefulness  
of Export-  
Import  
Bank

There may, however, still be a field for Export-Import Bank loans in Latin America even when the Inter-American Bank has reached maturity. The latter will hardly lend directly to the public without Government or Central Bank guarantee. Aid to American exporters and importers may still have to be given by the Export-Import Bank. Or there may be loans for developmental purposes in Latin America that this country will wish to see made even though the chances of an adequate financial return upon them are too uncertain to warrant investment by the Inter-American Bank, which must prove itself a real banking institution, and not an instrument of subsidy, if it is to command the confidence of the public. In any case the Export-Import Bank will continue to occupy a world sphere of business outside the Latin American countries.

2. Should Federal Reserve Bank acquisition of Inter-American Bank obligations be limited to an amount equivalent to the surplus of Federal Reserve Banks?

Senator Glass has proposed that the Federal Reserve Banks should be permitted to lend to the Inter-American Bank no more than their surplus as of December 31, 1941. The draft of the enabling legislation as sent to Congress by the President would permit the Federal Reserve Banks to purchase obligations of the Inter-American Bank without limit subject to the consent of the Board of Governors of the Federal Reserve System and to such regulations as the Board may establish. While the limitation proposed by Senator Glass appears to be unnecessary in view of the long experience of the Federal Reserve Banks and the supervisory powers of the Board, it would make little difference in the early years. As of the end of 1941 the Federal Reserve Banks had an earned surplus of 157.5 million dollars and a surplus under Section 13b of 26.8 million dollars. Even if surplus under 13b were excluded, there would be room for considerably more accommodation to the Inter-American Bank than the Federal Reserve Banks will want to extend for some time to come. If later on it should appear advisable to expand the limits of Federal Reserve accommodation, an appropriate recommendation could be made to Congress in the light of what the Inter-American Bank had by then accomplished and the further activities that it contemplated.

3. Should the Federal Reserve Banks extend credit to the Inter-American Bank only through notes with a maturity not in excess of 4 months?

Senator Glass has also proposed that "no loan, advance or extension of credit shall be made by any Federal Reserve Bank to the Inter-American Bank except upon its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of the Federal Reserve Banks".



This is a more serious limitation than that confining the aggregate credit extended to an amount equivalent to the surplus of the Banks. Several questions suggest themselves. Is the term "notes" sufficiently broad to cover the whole range of credit operations in which the Federal Reserve Banks might properly engage with regard to the Inter-American Bank? Might the requirement of security on every operation prove onerous in some types of transaction or does the phrase "to the satisfaction of the Federal Reserve Bank" provide sufficient flexibility in such cases? Finally, there is the question posed by the 4-months maturity. Latin American banking business tends to longer-term arrangements than are characteristic in the United States. Freight is slower. The proportion of agricultural credit is higher. For the Inter-American Bank to borrow for only 4 months or less in connection with its Latin American business might seem somewhat unrealistic.

In particular this might be the case where the issue of debentures was involved. The debentures of the Bank have been considered more as a form of intermediate or long-term borrowing. The Federal Reserve System must have freedom to buy the Bank's debentures if action is to be taken through the Open-Market Committee. This is probably the most efficient form of action that the Federal Reserve System can take since all 12 Banks must share pro rata and individual boards of directors will not have to pass upon the operation.

None of these difficulties appears to be insuperable. The Inter-American Bank could accommodate itself to the Glass amendment by issuing 4-months debentures fully secured and selling them to the Federal Reserve Banks with an understanding that the Federal Reserve Banks would renew their purchases over, say, a period of a year. It would probably be more satisfactory, however, to permit Federal Reserve credit to be extended to the Inter-American Bank in any form (not just secured notes) for periods ranging, according to the type of credit, up to a maximum of one year. With this arrangement renewal agreements, while still permissible, might seldom be needed.

4. Should the proposed charter of the Inter-American Bank be altered to prevent amendments to the By-laws of the Bank from becoming effective until ratified by our Congress?

Senator Glass has proposed changing the charter of the Bank so that amendments made to the By-laws would be without effect until ratified by our Congress. This hardly appears feasible. It would require renegotiation of the Convention

with the eight other signatories; and it would stimulate other countries to demand that amendments should be subject to ratification by their legislatures as well. Thereafter inertia on the part of any one of these bodies could hold up rectification of the Bank's By-laws indefinitely. The whole move would be a source of much embarrassment to the United States.

The essence of the proposal so far as this country is concerned, however, could be achieved without any international negotiation. As the By-laws now stand they can be amended only by a four-fifths vote of the Board of Directors. If the United States acquires more than one-fifth of the vote, no amendment to the By-laws can be made without the consent of the U.S. director. Since the U.S. director represents this country, he may be appointed and controlled in any way the Government deems best. Under the arrangement embodied in the tentative bill now before Congress the U.S. director would be appointed by a committee of four -- the Secretaries of State and the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the Federal Loan Administrator (presumably the last-named will now have to be changed to the Secretary of Commerce). The director must keep this committee informed and is to serve for two years subject to its pleasure. Congress, however, may alter this proposed arrangement at will. If it wishes, it may require the U.S. director to vote against any amendment to the By-laws of the Bank unless he has the express consent of Congress, or some Congressional committee, to a vote in its favor. This would, in effect, make every proposed amendment to the By-laws of the Bank subject to approval by our Congress.

While it is thus possible to achieve Senator Glass's end without international negotiation, there may be some question as to the advisability of tying the American director down so closely. Conceivably a limitation of this sort on the director's responsibility might make it more difficult to obtain an able man for the post; and the requirement of a Congressional vote on every amendment to the By-laws of the Bank that was under consideration might prove to be too rigid and time-consuming a procedure.

5. Should the power of the Inter-American Bank to issue debentures and other obligations be limited with relation to its capital and surplus?

A question of this character was raised in the May 1941 meeting of the Foreign Relations Committee. It seems to focus attention on the wrong item. If liabilities are being limited, it is less important to limit long-term obligations

than it is to limit deposits that can be withdrawn upon demand. The limitation should, however, apply to vulnerable assets. Properly considered, capital and surplus of the Bank should be a protection to all the Bank's creditors against a shrinkage of assets. Cash and short-term assets are far less subject to shrinkage than longer-term assets. Hence it is these longer-term assets (rather than debentures, which are irrelevant) that should be limited to some multiple of capital and surplus. Such a limitation is contemplated in section 3, G of the By-laws, which states:

"The Board of Directors, within a year after its first meeting, shall by regulations prescribe the reserves to be established and maintained against demand deposits and other obligations of the Bank and shall prescribe a limitation on the amount of intermediate and long-term assets in relation to capital and surplus; and such regulations shall not be amended, modified, or revoked except by a four-fifths majority vote of the Board."

A definite limitation of this character was not imposed in advance in the By-laws because insufficient evidence was at hand with regard to the probable nature of the Bank's business to enable a precise ratio to be named. It was considered that an appropriate limitation could better be determined by the Board of Directors itself after some experience had been gained with the Bank's operations. Since the Bank will have to depend largely on official funds until it has demonstrated its strength, it seems certain that it will draw little from the general public until after the first year, by which time its reserve requirements and the limitation on its longer-term assets with reference to capital and surplus will have been fixed.

6. Are the tax immunities granted to the Bank, and to those who derive income from it, consistent with the effort to get rid of tax exemptions in this country?

This question also appears to have been raised in the May 1941 meeting of the Foreign Relations Committee. The Treasury has answered it in the affirmative in a 5-page memorandum. The memorandum emphasizes the Governmental and international character of the Bank, points out the advantages of protecting the Bank from taxation which might limit its activities in the various countries, and states that it would be improper for this country to profit financially from the fact that the Bank is required to have its head office here.

The Convention permits non-discriminatory taxation of any citizen of the taxing country; and the Treasury memorandum states that the exemptions given to aliens are similar to those already in effect and that the immunities granted directly to the Bank are similar to those now being accorded Governmental institutions.

This is by no means a full summary of the Treasury argument. It is suggested that the question, which is highly technical, should be held for reference to the Treasury if it is raised in Congressional hearings.

W.R.G.