Speech delivered before
Annual Convention of Ohio Bankers Association
Columbus, Ohio
May 16, 1946

# OUR FOREIGN LENDING PROGRAM

Most of Europe and important sections of Asia find themselves entering the period of peace with only a fraction of their normal export trade. They have not adequate means of their own to pay for the great volume of imports that they must have if their populations are to be kept alive, the damage of the war repaired, and their industries restocked with raw materials and set functioning again. Once this job is done, the warstricken countries will be able to look after themselves. They will once again have the exports necessary to pay for the goods they need and to service the debts they have incurred in process of rebuilding. Until this has been achieved, however, the United States, which has built up its productive power during the war, must be prepared to supply the goods and the needed financing on a great scale. Since this is a constructive job -- one that strengthens the economies of the countries and expands their output -- it is entirely appropriate that most of it should be done through loans rather than by a mechanism such as Lend-Lease. The countries that receive our aid will by reason of that very fact be placed in position to repay us in the years ahead. We are already engaged upon this lending program and I hope to give you a brief picture of it and the philosophy behind it in my talk today.

First, let me say, however, that we are going into it with our eyes open. We have not forgotten what happened to the investments that we had abroad in the 1920's. Our experience then was bad in many respects though not as bad as is commonly supposed. As a matter of fact on our total foreign investment in the 1920's we have received an aggregate service in dollars, which together with the undefaulted loans and equity holdings, is well in excess of the money we invested. Speaking very broadly, we have received something like the equivalent of 3 or 4 per cent return on the whole investment. This is primarily due to our good experience on direct business investments abroad and, in any case, it is far short of the 8 or 9 per cent which was charged on many individual loans in the 1920's; but rates of that magnitude give fair warning that the loan that is being made is a pretty poor risk. And such rates constitute a burden on the balance of payments of the debtor country that is almost impossible to carry when a major world depression strikes.

This time the rate of interest we are charging on reconstruction loans is in the neighborhood of 3 per cent -- a rate which, as I have just remarked, appears to have been actually realized on the investments of the 1920's as a whole. Also, this time foreign loans are being carefully screened to meet only the most urgent and productive needs. They are not being blindly pressed upon countries to finance undertakings that are beyond their means. They are being judged in terms of the effects they will have upon the whole economy of a country and its international position. And notwithstanding the enormous uncertainties of the years ahead, there are new factors in the situation that afford some hope about lending in the light of experiences during the 1920's, lending policy as it should be now i.e. who should get the money on what terms and what are the chances to receive interest payments and principal.

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The chief ground for this hope is that we have probably learned enough in the last ten or fifteen years to prevent the full recurrence of such a depression as then occurred. While we are far from having mastered the problem of how to keep a free economy running smoothly at maximum production -- while there are many years of trial and error ahead -- we have, I believe, learned enough to prevent the most extreme fluctuations. Steadier economies in the major countries will lessen the disturbances to international trade. In addition, the most upsetting element in the international situation in the 1930's -- great capital flights -- will be severely under control in most countries in the years ahead. All this will tend to limit the size of the international deficits we must face. And as these deficits occur the International Monetary Fund, an institution which was not available in the 1930's, will swing into action. It will use its position to help assure that adequate corrective measures are taken and taken in time. While they are being taken and until they can bear fruit, the Fund will be prepared to assist a country financially by making foreign exchange resources temporarily available to it. Not only will countries have access to the billions of dollars available in the International Monetary Fund, but they already have gold and dollar reserves of their own, which are more than double the reserves that were available to them to meet the crisis of the 1930's. These reserves are not, of course, evenly distributed according to need, and in any case they must largely be used for currency stabilization purposes rather than for the reconstruction job. That job is too big for them. But the loans made for reconstruction will be safer if a larger measure of currency stability and freedom of exchange markets is achieved.

Here then are four major reasons -- diminished business fluctuations, control of capital flights, action of the International Monetary Fund, and larger basic reserves abroad of gold and dollar exchange -- four major reasons why the international financial breakdown of the 1930's is not likely to be repeated on the same scale again. I might add to this list of economic factors the progress that we hope to make in the forthcoming conferences on commercial policy. If these conferences achieve substantial reductions in the barriers to international trade and open the field more widely to private enterprise and competition, the effectiveness of measures designed to correct balance of payments deficits will be correspondingly enhanced. Even on the political front, although the immediate problems are great, we are better organized than in the anarchic period of the 1930's; for now we have the United Nations embracing all the great powers and with the United States playing a full and purposeful role. The possibility that war will cut across the whole pattern of international investment is materially lessened though, of course, far from eliminated by the United Nations Organization.

All of this may sound a bit optimistic to you bankers. I can sympathize with that feeling. If one looks only at the problems that face us today in the international sphere, there can be few grounds for optimism. The problems themselves are unprecedented, and it would be a bold man who would predict in just what way this war-stricken world will finally settle down. What I have been trying to emphasize, however, is that we are far better organized, and equipped to deal with these problems than we were with those which were left behind by the first World War. We should not just sit back and assume that history will repeat itself. The basis of international investment has been strengthened in many important respects and we are taking what the generals would call "calculated risks" when we come to the assistance of the war-damaged countries of Europe and Asia. If we can aid these countries to get back on their feet; if we can tide them over these first years when their shortages are temporarily acute and their means of paying for them through exports are not yet restored; if we can help them to obtain the means to help themselves; then we may find not only that they can repay us what we have lent, but that they are strong enough to participate with us in building a world of free enterprise and expanding employment and production. It is in that sort of world that democracy can best thrive.

We have kept these purposes clearly before us in the lending program we have undertaken. The key loan is, of course, that to the British. The United Kingdom is the greatest trading nation in the world and the pound sterling is the currency in which much of the world's business is carried on. The many countries that export to England more than they buy from her were at one time able to employ the sterling proceeds of their sales to buy outside the sterling area -- particularly in the United States. Under war conditions this freedom was lost. England could not possible restore it again in the difficult transition years without the aid of the American loan. She doesn't have the dollars. Without the loan she would be driven to desperate measures -- to a whole series of bilateral deals, every one of which would discriminate against the United States and would draw world trade away from its most productive channels. Although in the end this system would seriously shrink world trade as a whole and work against Britain's own interests, the United Kingdom would be forced to get what she could out of it in the critical transition years. Anything gained in that period when exports were still insufficient to pay for the most urgent import needs would be worth considerable sacrifice of future potentialities. Once set on this path it would be hard for her ever to disentangle herself. So many vested interests would grow up around the discriminatory bilateral arrangements that even the Bretton Woods Fund could hardly blast them loose And with England playing this sort of economic game the chances for cooperation in the political field would be jeopardized.

The loan agreement with the British, therefore provides specifically that, within one year from the date when the agreement becomes effective, sterling due on current transactions with any part of the world shall be made convertible unless the United States consents to an extension of time. This is written into an agreement in which $3,750,000,000 is provided to help England purchase the supplies she will urgently need before her exports and other sources of international income build up sufficiently to enable her to pay her own way. Because the loan deals with a key situation and has larger objectives than a mere financial transaction, it is on a larger scale and on more liberal terms than any other contemplated by the United States. It has been laid before Congress for approval; and the funds, if supplied, will be voted by Congress for this specific purpose.

The remainder of the United States lending program is largely being carried out by the Export-Import Bank. Substantial credits, to be sure, are being extended by other agencies in connection with the sale of Lend-Lease inventories and surplus property abroad, and the Maritime Commission has been authorized to sell ships on credit. All this is helping to meet the needs of Europe and Asia on the basis of deferred payments. But the loans of actual money are being made almost entirely by the Export-Import Bank.

Our policy on Export-Import Bank loans has been to meet only the most pressing needs that must be financed before the International Bank for Reconstruction and Development is ready for business. The resources of the Export-Import Bank were increased last summer from $700 million to $3,500 million and the President has stated that he will ask Congress for another $1,250 million to enable the Bank to complete its part of the reconstruction job. Substantial loans have already been authorized to France, Belgium, Netherlands, Denmark, Norway, Finland, Poland, and Greece and still larger loans to these and other countries are now under discussion. The programs have been pared down repeatedly; but the rock-bottom needs that must be met before the International Bank is ready to take over remain on a vast scale.

Reconstruction loans by the Export-Import Bank have been made on a 3 per cent 20-year basis except for a few special loans for 30 years at 2-3/8 per cent. These special loans have been made only to France, Belgium and the Netherlands and have been for the purpose of financing goods authorized under the Lend-Lease program but ordered after the end of the war. They amount to about $650 million. The remainder of the great Export-Import Bank reconstruction loans, which are on a 3 per cent basis with serial maturities, may in the course of time prove salable in some measure to the private market. This is particularly likely in the case of the shorter maturities.

The Bank is anxious to sell as much as it can to the market because it is under a legal directive to supplement private investment rather than compete with it and because the more it can sell, the more resources it will have to do those parts of the job which private investors are not yet ready to do. As you know, the $200 million loan recently made to the Netherlands Government was opened to the banks of the country on a participation basis. Since it was an extremely short maturity of from 1 to 2 years and bore an interest rate of 2-1/4 per cent it is not surprising that $100 million of it was in fact taken by the banks. It is not, to be sure, the usual type of loan provided for reconstruction purposes. That would require a much longer term. The $200 million credit is merely in anticipation of other measures that the Dutch will take to borrow here or liquidate their assets. Nevertheless it is cause for considerable satisfaction that a market which is extremely cautious about resuming international lending after the experiences of the 1930's has made on this occasion so substantial an investment.

The chief channel through which private funds will flow abroad in the immediate future, however, is likely to be obligations of the International Bank. The major part of the Bank's lending will be financed with funds raised in the market, since the Bank can use only 20 per cent of its own capital for making loans. The remaining 80 per cent can be called up only to the extent it may be needed to meet the obligations of the bank. The Bank may raise funds either by issuing its own securities or by guaranteeing the issues of foreign borrowers. In either case private investors will be supplying funds to foreigners while the Bank assumes the credit risk.

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I should be interested to have your comments on the market prospects for bonds of the International Bank. It is possible that there will be an offering of such bonds before the year is out. As you know, the International Bank came into existence last December, and in March the first meeting of its Board of Governors was held in Savannah. The smaller working group of Executive Directors to whom the Board has delegated most of its powers is even now in session in Washington. The President of the Bank will have to build up a staff, and this may take some months. Gradually the Bank will acquire working funds through calling up a portion of its capital. Under its statutes, however, it can hardly call up much more than $400 millions of dollar subscriptions before the fall; and if, as seems likely, the demand of foreign countries is predominantly for dollar resources, it may be necessary for the Bank at an early date to offer its bonds for sale in this country.

At the outset insurance companies and savings banks in many States may find that the existing legislation does not provide for purchase of this new type of bond. Until a few months ago this was the case in New York; but through prompt action a law was passed permitting the savings banks of that State to invest in the obligations of the new International Bank when they become available. Commercial banks in general will be free to invest up to 10 per cent of their capital and surplus. It will be for them to determine to what extent they wish to purchase securities of the International Bank, taking into account maturity, risk, marketability, etc. The Bank will undoubtedly exercise great care to adapt the form of its securities to the potential market which it finds available.

As regards the basic risk involved I might make one comment. The Bank cannot lend more than its unimpaired subscribed capital, surplus, and reserves, which today amount to about $7,600 million. Hence if it borrows and lends to the maximum possible, both its loans and its obligations will amount to about $7,600 million. The obligations will be covered to the extent of about $3,200 million by the United States subscription. The remaining $4,400 million will be covered by claims against foreign governments and central banks amounting to about $12 billion -- i.e., $4,400 million of foreign government subscriptions to the capital of the Bank plus the $7,600 million of loans, all of which must have behind them the credit of a government, central bank, or similar institution acceptable to the International Bank. This $12 billion of claims against foreign governments or central banks would have to shrink through defaults to $4,400 million before the bonds of the International Bank would cease to be covered in full. No such shrinkage as this occurred in the servicing of our foreign investment during the ill-fated 1930's and there is little reason to believe that it will occur in the decades ahead -- particularly in view of the factors to which I have called your attention earlier in this talk.

If the securities of the International Bank find a ready market in the United States it should be able in 1947 to relieve the Export-Import Bank of most of the burden of making reconstruction or development loans While the shift from the Export-Import Bank to the International Bank wi be from an agency of the United States to an institution representing some 40 nations, the predominant role of the United States in international lending will not be greatly altered by the change. As I have already remarked, the United States investment market will be expected to supply most of the International Bank's funds. Furthermore the American director of the bank wields about 37 per cent of the total voting power. Even more important than this, however, are the provisions under which the consent of the United States is required before the Bank can lend the dollars subscribed by the United States or can float or guarantee an issue in the American market.

The power to give or withhold consent in these cases has been assigned by Congress to a new body which already has assumed primary importance in our international lending picture. I refer to the National Advisory Council on International Monetary and Financial Problems, commonly known as the N.A.C. This Council is composed of three Cabinet members -- the Secretaries of State, Treasury, and Commerce -- and the Chairmen of the Federal Reserve Board and the Export-Import Bank. These five men have been given the task of coordinating the foreign lending policies and financial operations of this Government and of the United States representatives on the International Bank and the International Monetary Fund. It is for them to keep the whole program that I have been discussing in this talk in proper proportion and order. Not only must it be adapted to the needs and capacities of one foreign country as against another, but it must be fitted into the position of our domestic economy in such a way as to help preserve its stability. The N.A.C. is taking its task with the utmost seriousness. The Secretary of the Treasury is chairman and there are regular meetings in his office. The group is constantly shaping and reviewing the lending program of this country, both in detail and as a whole. As the International Fund and Bank come into full operation the task of the N.A.C. will be increased. But it is already clear that an adequate system has now been devised for bringing together the Government agencies primarily concerned with our foreign financial policy. I believe that you have in this Council the best assurance you could ask that the lending program of the United States will continue to be broadly conceived and well-integrated, and that it will make the most effective use of our admittedly limited resources. It will be powerfully directed toward rebuilding the kind of international world in which American free enterprise can thrive side by side with foreign enterprise, and the foundations of the peace can be made secure.