March 14, 1947

MEMORANDUM to Mr. Martin:

The President's Speech and the Bretton Woods Institutions

Introduction. If the United States undertakes unequivocally political foreign lending in accordance with the President's recommendation, this will mean that the Bretton Woods hope of completely non-political post-war reconstruction lending on an international risk-sharing basis will have been shattered by events since V-J day. The implications for the two Bretton Woods institutions of the abandonment by the United States of this hope and the substitution therefor of a mixed economic and political lending program are obviously considerable.

International Bank. The first and foremost effect of a U.S. political loan program on the Bank would, I think, be to make it imperative for the Bank (with active U.S. Govt. support) to create as rapidly as possible a sharp differentiation in the U.S. public mind between its loans (and Eximbank reconstruction loans) and the U.S. political loans. The great danger the International Bank faces is that a large segment of the investing community will, for the time being at least, be completely discouraged from investing in its debentures by the following general line of reasoning:

> The U.S. political loans are really peace-time lend-lease grants that will never be repaid. They are prelude to growing tension and perhaps ultimate conflict with the USSR. Even if the worst does not happen, many of the countries that borrow from the International Bank (and Eximbank) will eventually take their ~~case~~ cue from the U.S.

political loans and choose to regard their loans as political in the same sense and default on them at a convenient opportunity.

The problem of the International Bank, under these circumstances, would be to do everything possible to reassure potential investors that:

a) the Bank's loan will be economically sound and have every reasonable prospect of repayment;

b) the Bank's loans will be made to countries that will make every effort to service them and preserve their credit standing.

The U.S. investing public will somehow have to be sold on the economic as well as political wisdom of a "mixed" program of sound, economic reconstruction loans (of the International Bank and Eximbank) and entirely separate political loans handled directly by the U.S. Government. I believe that the accomplishment of this will require the concerted efforts of the U.S. Government (acting through the NAC) and the International Bank and even then it will probably be a difficult task. A U.S. political loan policy initially is likely to have quite a dampening effect on the International Bank's sale of debentures. The more cautious elements of the investing public will want to wait and watch developments before forming an opinion on whether the "mixed" program is possible. Even assuming that the U.S. policy is followed rather promptly by a sharp improvement of the general political atmosphere, many of the investors will still want to be reassured on several points before buying the Bank's debentures:

(a) How the U.S. handles the political loans. In view of the known weakness of the Greek Government, any signs of fumbling the administration of the loans will provoke growing skepticism as to the ultimate success of the program and corresponding doubts as to the success of any mixed lending program. It seems to me that highly effective administration of the U.S. political loans is absolutely vital to success of the mixed program.

b) How seriously the debtors of the International Bank take their obligations. You will recall my fear that the most favorable loan terms granted by the U.S. in this period will tend eventually to become standard terms for the Eximbank loans. If the political loans show signs of going bad, and the Eximbank loans threaten to follow suit, the incentive for debtors of the International Bank to service their obligations will drastically decline. It is my feeling, therefore, that any differentation between the "political" and "economic" loans will probably be more apparent than real and that the "political" loans will have to turn out to be good for the "economic" loans to work out successfully.

International Montary Fund. The basic practical policy issue confronting the Fund today as it begins operations is to what extent it should yield to the pressure from its member countries to borrow dollars from it for reconstruction purposes. This, the so-called automatic vs discretionary lending, issue is before a group of Executive Directors who have divergent viewpoints ranging from the official U.S. position that borrowing from the Fund should be only for seasonal and cyclical, i.e., "short-run" purposes to the position that countries should be free to draw down their quotas at will.

The degree of pressure to use the Fund during the first year as a supplemental source of reconstruction loans will obviously be influenced by the extent to which the 1947 reconstruction needs of member countries are met from other sources, especially the International Bank, the Eximbank, and the U.S. political loan program. It so happens that any U.S. political lending will be to countries (Greece, Turkey, China, Italy) which are not likely to borrow from the Fund this year. If the U.S. political loan program should serve to curtail the volume of International Bank lending during 1947 the probably consequence would be to increase the pressure from the Western European countries (especially France) to draw down their full first year Fund quotas and use the dollars so obtained for reconstruction purposes. If the U.S. program should increase the skepticism of member countries as to the ultimate success of the Fund it will furnish an additional incentive to borrow from the Fund as quickly as possible. On the other hand, if the program should result in an expansion of International Bank lending and a feeling on the part of member countries that the prospects of success of the Fund were enhanced, the consequence would be to reduce the pressure to draw on the Fund during 1947.

It is thus clearly impossible at this time to predict the effect of a U.S. political loan policy on the Fund. Its impact will be indirect and indeterminate and the consequences on the Fund's policy largely dependent on the way in which the political loan policy affects the general political atmosphere and the economic reconstruction lending.