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IMC(44)B.4.
22nd June, 1944.

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INTERNATIONAL MONETARY FUND

Memorandum by Lord Keynes

The Reconstruction Bank.

A Clause to authorise Stabilisation Loans

1. Between III(5) and (6) - (new numeration), insert a new Clause as follows:-

"In general, loans made or guaranteed by the Bank, shall be for the purpose of specific projects of reconstruction and development, and except as otherwise provided in this plan, the proceeds of loans shall only be made available to meet specific purposes.

In exceptional circumstances, however, the Bank, acting in agreement with the International Monetary Fund, may make or guarantee a loan which provides the borrowing country with gold or foreign exchange for the purpose of establishing its exchanges and allowing a breathing space for the recovery of its economy and the balancing of its international payments".

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I. .C.(44)(B) 2 Copy No. 27

21st June 1944

The Bank for Reconstruction and Development

Memorandum by Lord Keynes

The U.K. Delegates propose the following modifications In the U.S. Treasury Draft dated November, 1943:-

1. Substitute for II(4) and (5):-

"4. The subscribed capital of the Bank shall be divided into two parts as follows:-

(a) 20 per cent of the subscription of each member country shall be callable by the Bank as and when required, some portion of which (not to exceed 20 per cent) shall be paid in gold and the remainder in local currency. The proportions to be paid in gold and local currency shall be graduated according to an agreed upon schedule which shall take into account the adequacy of the gold and free foreign exchange holdings of each member country. These subscriptions shall be available for direct loans made by the Bank out of its own funds under (IV)(1)(a) below.

(b) The remaining 80 per cent shall be callable by the Bank, as and when required to implement, where necessary, guarantees given by the Bank under IV(1)(b) and (c) below and shall not be callable for any other purpose. Amounts callable under this clause shall be paid either in the currency required to implement the guarantee or in gold or in currency which is convertible under the terms of the I.M.F."

2. Omit II(6) as being an unnecessary complication at this stage. No doubt, this could be arranged subsequently by mutual agreement if and when it becomes advisable.

3. Omit II(7). Since under the new clause II(4)(b), proposed above, the whole of the 80 per cent. is liable to be called otherwise than in local currency, this is not necessary.

4. Substitute for II(8):-

"The local currency subscribed under II(4)(a) above shall not be expended except with the permission of the member country under IV(4) below. Member countries agree that all other local currency holdings and other assets of the Bank located in their country, provided that they have been acquired or borrowed with their permission, shall be free from any special restrictions as to their use."

5. Omit (III) altogether in the Statutes and leave it to the Bank to decide by regulation in what form to keep its accounts.

6. Substitute for the title of IV:

"III. General provisions for loans to member countries"

7. In IV(1)(c), omit all the words after "borrowing country" in the fourth line. Part of this passage is dealt with in III(6) below, and part of it seems of too detailed a character for the Statutes.

8. In IV(1)(e) after "interest" add "and commission".

9. Omit IV(2), (3), (4) (5), (10), (11), (12), (13) and (14) which are dealt with in a new Section V below.

10. Renumber IV(6), (7), (8), and (9) as III(2), (3), (4) and (5).

11. At the end of (8) (to be renumbered (4), add:

"(e) orders are placed by the borrowing country, without unduly encroaching on its discretion, with due attention to considerations of cheapness and efficiency and regardless of political or other non-economic influences or considerations."

12."(6)In making or guaranteeing a loan the Bank shall pay due regard to the prospects of the borrowing country being in a position to service the loan; and in determining the destination, the character and the volumeof its loans it shall act prudently in the interests both of the borrowing member country and also of the guaranteeing members. At the same time it shall not seek to avoid the incurring of some measure of reasonable risk (taking account of the commission chargeable - see below), where the loan is in the general interests of reconstructing or developing the world's resources or expanding international trade along mutually advantageous lines; and shall seek to conduct its operations taken as a whole in such manner as to avoid, so far as possible, the calling up of the capital reserved for guarantees, rather than seek full security from risk in each transaction taken separately. These considerations shall govern the lending policy of the Bank especially in approving reconstruction loans to countries which have suffered from the war."

13."(7) It shall be a primary duty of the Bank to secure that investment is not made haphazard but that the more useful and urgent schemes are dealt with first; also to co-ordinate investment, whether loans are made or guaranteed by the Bank or through other channels; and in short to see that international lending is on a more wisely conceived plan than it was after the last war."

14. Make IV(15-19) into a new section entitled :

"(V) Miscellaneous Provisions"

re-numbering them (1) to (5) and at the end of (5) add:

"...which, acting with the strictest impartiality, shall pay particular regard, both in selecting the places of its borrowing and of its lending and when facilitating the choice of the place of expenditure, to maintaining the equilibrium of the international balances of payments of member countries".

15. For IV(2) - (5) and (10) - (14), substitute the following new section:-

IV. Powers and Operations

1. The Bank may facilitate the provision of loans to any member country, which satisfy the general conditions of (III), in any of the following ways:

(a) By direct loans out of the Bank's own capital subscribed under II(4)(a):

(b) By direct loans out of funds raised by the Bank under its own guarantee in the market of a member country;

(c) By guaranteeing in whole or in part loans made by private investors through the usual investment channels.

2. [The old IV(3)]

3. [The old IV (4)]

4. In the case of loans under 1(a) above, the borrowing country shall notify the Bank in which member countries it desires to incur expenditure to be met out of the loan, and the Bank shall make the required currencies available out of its subscribed capital, provided that the country whose local currency is to be supplied has agreed in each case. If local currency subscribed under II(4)(a) is not available in whole or in part, the Bank shall make it available out of its holding of gold or other free resources, if it possesses an adequate amount of such resources and is satisfied that, without this provision, the country in which the borrowing country desires to place the order, would have difficulty in maintaining the equilibrium of its international balance of payments. ? <Otherwise it shall request the borrowing country to transfer its proposed expenditure to another member country.> Furthermore, at the request of the countries in which portions of the loan are spent, the Bank will repurchase for gold or needed foreign exchange a part of the expenditures in the currencies of those countries made by the borrower from the proceeds of the loan.

5. The Bank shall not borrow funds under 1(b) above or guarantee loans under 1(c) above raised in the market of a member country, except with that member's approval and only if that member agrees that the proceeds of the loan may be expended in any member country without restriction. It

follows that, in the case of loans to member countries out of such funds or under such guarantees, there will be no exchange obstacle to the expenditure of the proceeds in the market of any member country in accordance with the preference of the borrowing country.

6. Loans made directly by the Bank to the borrowing country under 1(a) or (b) above shall contain the following payment provisions:-

(a) The annual service of the loan shall be made up of three parts, namely:

2 (i) a standard rate of interest fixed by the Bank annually and the same to all borrowers modifiable from time to time for new loans;

(ii) an annual commission at a flat rate fixed at 1 per cent. in the first instance but alterable by the Bank from time to time at its discretion ~~in the~~ for new loans light of experience, the same to all borrowers, to cover the general expenses of the Bank, and as a provision against risk (but the particular expenses of investigation, etc., attaching to the individual loan, may be charged separately against the borrowing country and may be paid out of the proceeds of the loan).

(iii) an annual contribution to amortisation either at a flat, or at a progressive, rate sufficient to repay the capital within a determined number of years, the length of which shall be fixed with regard partly to the character and purpose of the loan, but also with regard (especially in the case of post-war Reconstruction loans) to the capacity of the borrowing country to discharge the loan, not normally exceeding 30 years but extensible to 50 years in particular cases.

the loans and

(b) The annual service of the loan shall be paid in a convertible I.M.F. currency or in gold or, at the discretion of the Bank, in any other currency or assets acceptable to it.

(c) In the event of the borrowing country suffering from an acute exchange stringency, so that it is unable to provide the service of the loan in the stipulated manner, it may appeal to the Bank for a relaxation of the conditions of payment. If the Bank is satisfied that some relaxation is in the interests of the borrowing country and of the operations of the Bank and the other member countries as a whole it may take action under all, or any, of the following headings in respect of the whole, or part, of the annual service:-

(i) The Bank may in its judgment accept payments in respect of the service of the loan for periods not exceeding three years at a time in local currency. The Bank shall arrange with the borrowing country for the repurchase of such local currency over a period of years on appropriate terms that safeguard the Bank's holdings of such currency. The Bank may require that the whole, or part of such currency, may be transferred to another member country in whose hands it shall be freely available to make payments or to purchase exports in the borrowing country (see (9) below).

(ii) The Bank may re-arrange the instalments of amortisation so as to increase the amount due in later years or to prolong the life-time of the loan.

(iii) The Bank may make a Stabilisation Loan out of its free resources to the country which is in difficulties with a view to restoring the exchange value or increasing the convertibility of its currency.

This clause will be transferred elsewhere and given a less restricted status.

7. The Bank may guarantee loans to member countries through the usual investment channels, charging a flat rate commission of 1 per cent per annum (or other flat rate fixed by the Bank from time to time) payable to it direct by the borrowing country, provided that the Bank is satisfied as to the terms and conditions and purposes of the loan and that its proceeds will be freely transferable for purchases in any member country.

8. All guarantees given by the Bank under 1(b) or (c) above shall be secured only by its receipts from commissions and other profits and by the whole of its uncalled capital.

9. If there is any interruption in the service of a loan provided out of the proceeds of a loan guaranteed by the Bank under 1(b) above, or guaranteed by it under 1(c) above, the Bank shall first meet its obligations out of its net current or accumulated receipts from commissions or other profits. If this source is insufficient, it shall then call up from each member <u>pro rata</u> an appropriate amount of its uncalled capital, which shall be returned to the members meeting the guarantee if the arrears of the loan service are subsequently recovered. Subject to the approval of the Bank, a member part of whose subscription is being called up, to implement a guarantee given by the Bank, may purchase from the Bank the local currency of the country in arrears in lieu of paying up a part of its uncalled subscription.

10. A member country failing to meet its financial obligations to the Bank may be declared in default and it may be suspended from membership during the period of its default provided a majority of the member countries so decide. While under suspension, the country shall be denied the privileges of membership, but shall be subject to the obligations of membership. At the end of one year the country shall be automatically dropped from membership in the Bank unless it has been restored to good standing by a majority of the member countries. Any member country that withdraws or is dropped from the International Stabilization Fund, shall relinquish its membership in the Bank unless three-fourths of the member votes favor its remaining as a member.

11. If a member country elects to withdraw or is dropped from the Bank, it shall be repaid any part of its local currency subscribed under II(4)(a) above which remains in the hands of the Bank, and it shall not be liable to pay up any part of its uncalled subscription except such amount as may be required to implement guarantees given during the period of its membership (after allowing for commissions received in respect of guarantees given during the same period). Any further dividend, in respect of its interest arising from the part of its local currency originally subscribed and not returned to it as above, shall be paid in such amounts and at such times as the Bank, in its free discretion, may judge to be fair.

12. The yearly net profits shall be carried to a reserve to meet subsequent losses under guarantees or otherwise, and shall not be distributed except under the authority of a 75 per cent. vote of the Governing Body or on liquidation.

[No attempt is here made to amend V - Management (1 - 7 and 10)]

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21ST JUNE, 1944.

COPY NO. 27

BANK FOR RECONSTRUCTION AND DEVELOPMENT

GUARANTEES ON DIRECT LOANS

Note by Dr. Baranski

1. The Bank for Reconstruction and Development is proposed as an international financial agency to assist countries to issue their bonds on the market, through normal private channels, by guaranteeing such bonds under the conditions in IV(3). Direct loans to countries or corporations are only mentioned as a subsidiary or secondary part of the Bank's activities.

2. In the period after the war, however, it is rather to be assumed that this second form of activity on the part of the Bank would be more practicable. The Bank would then acquire bonds of various countries or corporations and hold them in its portfolio as collateral for its own bonds issued on the market, and would act in this way like an investment trust. There are some important reasons why the activities of the Bank should, in the first period, have the character mentioned above.

3. The credit of many countries, especially those which have been invaded by Germany, is and will be strongly affected by the war and its consequences. Even before the war, a high degree of political insecurity depressed the price of bonds of such countries (e.g. Poland) much below the level which would be justified by their economic position and actual ability to pay. It is difficult to believe that after the war, even when the service of loans is resumed again, quotation on the market would reach a higher level than before the war, i.e. about 50 for 100 (4½% bonds). Public confidence has been badly destroyed by the war and by the destruction of the country, and undoubtedly it will only be restored gradually and slowly. Even then, when, as we hope, the problem of political security is positively solved, it is difficult to believe that the additional guarantee of the Bank could improve the issue price of new Polish bonds more than, say, to 60 or 70 per cent. of their par value. It is rightly pointed out in the "Questions and Answers" on page 22 that "even on securities fully guaranteed by the Bank investors will have to consider the credit of the borrower and evaluate the security partly in terms of the borrower's reputation and financial position". But on the other side, the fact that bonds guaranteed by the Bank cannot obtain on the market the adequate standard price will in some way reduce the value of the Bank's guarantee. This would be a great danger, as the belief in the absolute value of Bank guarantees amongst the public cannot be taken for granted. Although backed by large capital and supported by the governments of financially strong countries, the Bank will be a new institution whose policy will not yet be sufficiently known, and it will take some time before the Bank's guarantee can acquire the standing of a guarantee by, for example, the U.K. or U.S. Government, which could give to any loan, even a weak one, the terms of issue approximate to government bonds of those countries.

/4.

4. As it is to be hoped that the Bank's main activity after the war will consist of giving loans for reconstruction of the devastated countries, it would be better if the Bank used ascollateral for its own bonds, all bonds acquired, i.e. resulting from loans to the devastated countries as much as loans of prosperous countries. Then the risk will be spread over a number of different countries - and the public will not necessarily consider the issue of the Bank's own bonds as particularly linked with loans to countries which until now have been rightly or wrongly considered as precarious debtors.

5. It is obvious, that such a policy must be confined to the period of reconstruction, until the settlement of all economic and financial conditions in the world has yet been achieved. In the future, it may be not only possible, but even necessary, to use the Bank's guarantee, as the best instrument to introduce directly into the market bonds of those countries, whose credit has in the meantime improved, because of their full reconstruction and the revival of confidence in their political stability and security. This will the stage which will permit the Bank to act entirely in conformity with the principles stated in I(1) of the memorandum on the Establishment of a Bank for Reconstruction and Development.

21st June, 1944.

Dr Feierabend

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12*th* ~~*March*~~, 1944.
June

Copy No. 30

A UNITED NATIONS BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROPOSALS AND COMMENTS THEREON

TABLE OF CONTENTS.

The proposals contained in this print are of a tentative and interim character and represent the provisional views of the experts of the two Governments. They in no way commit the United Kingdom or United States Treasuries or Governments.

27623

November 1943.

A UNITED NATIONS BANK FOR RECONSTRUCTION AND DEVELOPMENT.

ONE of the important international economic and financial problems which will confront the United Nations at the end of the war will be the unprecedented need for foreign capital. In the areas devastated by war or plundered and ravaged by the enemy, factories and mines, public utilities and railroads, public buildings and public works will have to be repaired or restored. In all of the United Nations, industries now producing war goods will require capital for reconversion to peacetime production. Finally, in many areas of the world, large investment will be needed for industrial, agricultural and commercial development.

Countries whose productive capacity has been seriously impaired by war will find that their industries cannot provide the capital goods and their people cannot provide the savings they require for reconstruction. Most non-industrial countries will of necessity be dependent upon foreign investment to acquire the funds for the purchase of machinery, equipment, and other capital goods for development. And even in those countries where a considerable part of the need for capital can be met locally, there will be some need for foreign capital to supplement the funds that can be raised at home.

With the return of an assured peace, private financial agencies may be expected to supply most of the needed short-term foreign capital. When the shipping situation is improved and peacetime industry here and abroad has recovered, many business firms will be eager to sell their products abroad on reasonable and even generous credit terms. And banks likewise will hasten to expand their foreign business, reopening and establishing branches abroad, and assisting in the financing of international trade.

It is not unreasonable to hope that with the return of peace there will also be a gradual resumption of long-term international investment, particularly in the form of the establishment of foreign branch plants and the acquisition of shares in established foreign enterprises. With the growth of confidence in monetary stability, foreign investments will gradually assume the form of publicly floated loans to governments and municipalities, and to public utilities and other industries.

This flow of private capital to war-stricken countries will be encouraged by an adequate program of international relief and rehabilitation which helps to quickly restore to a working basis the economic life of those countries. Another, and possibly even more important, stimulant to foreign investments, would be the existence of an international agency, such as the International Stabilization Fund, designed to promote stability of foreign exchange rates and freedom from restrictions on the withdrawal of earnings. Such an agency could do much to enhance the attractiveness of foreign investments.

While there will undoubtedly be substantial amounts of long-term foreign investment even in the early postwar period, the flow of capital to countries greatly in need of foreign capital is likely to be inadequate for many years to come. Private capital will understandingly hesitate to venture abroad in anything like the required volume. It has suffered too many losses from war, from depreciating currencies, from exchange restrictions, and from business failures and defaults. There is little evidence to justify the hope that in the years immediately after the war investors will lend the large sums that can be economically used in foreign countries.

Obviously, it would be desirable to encourage in every way, the provision of capital for productive purposes through the usual private investment channels, and to the extent that private investment is inadequate, to provide supplemental facilities. The problem is fundamentally an international problem and only an international governmental agency equipped with broad powers and large resources can effectively encourage private capital to flow abroad in adequate amounts and provide a part of the capital not otherwise available.

The primary aim of such an agency should be to encourage private capital to go abroad for productive investment by sharing the risks of private investors and by participation with private investors in large ventures. The provision of some of the capital needed for reconstruction and development, where private capital is unable to take the risk, is intended to remain secondary in the operations of such an agency. It should, of course, scrupulously avoid undertaking loans that private investors are willing to make on reasonable terms. It should perform only that part of the task which private capital cannot do alone.

The need for foreign capital will be so great and the provision of adequate capital so important that it would be extremely shortsighted to neglect this urgent international problem. If private capital should suffice there would then be little for an international agency to do, beyond encouraging private investment. If, however, private capital were to prove unable fully to meet the needs, then such an international agency would be able to fill the breach until private capital again flowed freely and the demand for foreign capital throughout the world became less urgent.

It is imperative that we recognize that the investment of productive capital in undeveloped and in capital-needy countries means not only that those countries will be able to supply at lower costs more of the goods the world needs, but that they will at the same time become better markets for the world's goods. By investing in countries in need of capital, the lending countries, therefore, help themselves as well as the borrowing countries. If the capital made available to foreign countries would not otherwise have been currently employed, and if it is used for productive purposes, then the whole world is truly the gainer. Foreign trade everywhere will be increased; the real cost of producing the goods the world consumes will be lowered; and the economic well-being of the borrowing and lending countries will be raised.

One great contribution that the United Nations can make to sustained peace and world-wide prosperity is to make certain that adequate capital is available on reasonable terms for productive uses in capital-poor countries. With abundant capital, the devastated countries can move steadily toward rehabilitation and a constantly improving standard of living. Nothing could be more conducive to political stability and to international collaboration. Without adequate supplies of capital, however, recovery in Europe and Asia will be slow and sporadic, and economic discontent and international bitterness will in time assume disturbing proportions. To spend hundreds of billions to fight a war thrust upon us and then to balk at investing a few billions to help assure peace and prosperity would appear to be a singularly unwise policy.

Accompaning this memorandum is a draft proposal for a Bank for Reconstruction and Development of the United and Associated Nations. The draft was prepared by the technical staff of the United States Treasury in consultation with the technical staffs of other departments of this Government. The proposal has neither official status nor the approval of any department of this Government. It is in outline form touching on the more important points and is intended only to stimulate thoughtful discussion of the problem in the hope that such discussion will call forth constructive criticism, suggestions, and alternative proposals for possible later submission to the appropriate authorities and to the public.

A United Nations Bank for Reconstruction and Development is proposed as another international agency needed to help attain and maintain world-wide prosperity after the war. It is designed as a companion agency to an International Stabilization Fund. Each agency could stand and function effectively without the other; but the establishment of such a Bank would make easier the task of an International Stabilization Fund, and the successful operation of an International Stabilization Fund would enhance the effectiveness of the Bank. Together, the two institutions could help provide a sound financial foundation on which private enterprise can build a prosperous world economy.

HENRY MORGENTHAU, Jr.,
Secretary of the Treasury.

Washington, D.C., November, 1943.

United States Treasury, November, 1943.

PRELIMINARY DRAFT OUTLINE OF A PROPOSAL FOR A UNITED NATIONS BANK FOR RECONSTRUCTION AND DEVELOPMENT.

Preamble.

1. The provision of foreign capital will be one of the important international economic and financial problems of the postwar period. Many countries will require capital for reconstruction, for the conversion of their industries to peacetime needs, and for the development of their productive resources. Others will find that foreign investment provides a growing market for their goods. Sound international investment can be of immense benefit to the lending as well as to the borrowing countries.

2. Even in the early postwar years it may be hoped that a considerable part of the capital for international investment will be provided through private investment channels. It will undoubtedly be necessary, however, to encourage private investment by assuming some of the risks that will be especially large immediately after the war and to supplement private investment with capital provided through international co-operation. The United Nations Bank for Reconstruction and Development is proposed as a permanent institution to encourage and facilitate international investment for sound and productive purposes.

3. The Bank is intended to co-operate with private financial agencies in making available long-term capital for reconstruction and development and to supplement such investment where private agencies are unable to meet fully the legitimate needs for capital for productive purposes. The Bank would make no loans or investments that could be secured from private investors on reasonable terms. The principal function of the Bank would be to guarantee and participate in loans made by private investment agencies and to lend directly from its own resources whatever additional capital may be needed. The facilities of the Bank would be available only for approved governmental and industrial projects which have been guaranteed by national governments. Operating under these principles, the Bank should be a powerful factor in encouraging the provision of private capital for international investment.

4. By making certain that capital is available for productive uses on reasonable terms, the Bank can make an important contribution to enduring peace and prosperity. With adequate capital, countries affected by the war can move steadily toward reconstruction, and the newer countries can undertake the economic development of which they are capable. International investment for these purposes can be a significant factor in expanding trade and in helping to maintain a high level of business activity throughout the world.

I.—*The Purposes of the Bank.*

1. To assist in the reconstruction and development of member countries by co-operating with private financial agencies in the provision of capital for sound and constructive international investment.

2. To provide capital for reconstruction and development, under conditions which will amply safeguard the Bank's funds, when private financial agencies are unable to supply the needed capital for such purposes on reasonable terms consistent with the borrowing policies of member countries.

3. To facilitate a rapid and smooth transition from a war-time economy to a peace-time economy by increasing the flow of international investment, and thus to help avoid serious disruption of the economic life of member countries.

4. To assist in raising the productivity of member countries by helping to make available through international collaboration long-term capital for the sound development of productive resources.

5. To promote the long-range balanced growth of international trade among member countries.

II.—*Capital Structure of the Bank.*

1. The authorized capital shall be equivalent to about $10 billion consisting of shares having par value equal to $100,000.

2. The shares of the Bank shall be non-transferable, non-assessable, and non-taxable. The liability on shares shall be limited to the unpaid portion of the subscription price.

3. Each Government which is a member of the International Stabilization Fund shall subscribe to a number of shares to be determined by an agreed upon formula. The formula shall take into account such relevant data as the national income and the international trade of the member country.

Such a formula would make the subscription of the United States approximately one-third of the total.

4. Payments on subscriptions to the shares of the Bank shall be made as follows:—

(*a*) The initial payment of each member country shall be 20 per cent. of its subscription, some portion of which (not to exceed 20 per cent.) shall be in gold and the remainder in local currency. The proportions to be paid in gold and local currency shall be graduated according to an agreed upon schedule which shall take into account the adequacy of the gold and free foreign exchange holdings of each member country.

(*b*) The member countries shall make the initial payments within 60 days after the date set for the operations of the Bank to begin. The remainder of their respective subscriptions shall be paid in such amounts and at such times as the Board of Directors may determine, but not more than 20 per cent. of the subscription may be called in any one year.

(*c*) Calls for further payment on subscriptions shall be uniform on all shares, and no calls shall be made unless funds are needed for the operations of the Bank. The proportion of subsequent payments to be made in gold shall be determined by the schedule in 11–4–(*a*) as it applies to each member country at the time of each call.

5. A substantial part of the subscribed capital of the Bank shall be reserved in the form of unpaid subscriptions as a surety fund for the securities guaranteed by the Bank or issued by the Bank.

6. When the cash resources of the Bank are substantially in excess of prospective needs, the Board may return, subject to future call, uniform proportions of the subscriptions. When the local currency holdings of the Bank exceed 20 per cent. of the subscription of any member country, the Board may arrange to repurchase with local currency some of the shares held by such a country.

7. Each member country agrees to repurchase each year its local currency held by the Bank amounting to not more than 2 per cent. of its paid subscription, paying for it with gold; provided, however, that:—

(*a*) This requirement may be generally suspended for any year by a three-fourths vote of the Board.

(*b*) No country shall be required to repurchase local currency in any given year in excess of one-half of the addition to its official holdings of gold during the preceding year.

(*c*) The obligation of a member country to repurchase its local currency shall be limited to the amount of the local currency paid on its subscription.

8. All member countries agree that all of the local currency holdings and other assets of the Bank located in their country shall be free from any special restrictions as to their use, except such restrictions as are consented to by the Bank, and subject to IV–13, below.

9. The resources and the facilities of the Bank shall be used exclusively for the benefit of member countries.

III.—*The International Monetary Unit.*

1. The monetary unit of the Bank shall be the Unitas of the International Stabilization Fund (137–1/7 grains of fine gold, that is, equivalent to $10 U.S.).

2. The Bank shall keep its accounts in terms of unitas. The local currency assets of the Bank are to be guaranteed against any depreciation in their value in terms of unitas.

IV.—*Powers and Operations.*

1. To achieve the purposes stated in Section I, the Bank may guarantee, participate in, or make loans to any member country and through the government of such country to any of its political subdivisions or to business or industrial enterprises therein under conditions provided below :—

(*a*) The payment of interest and principal is fully guaranteed by the national government.

(*b*) The borrower is otherwise unable to secure the funds from other sources, even with the national government's guaranty of repayment, under conditions which in the opinion of the Bank are reasonable.

(*c*) A competent committee has made a careful study of the merits of the project or the program and, in a written report, concludes that the loan would serve directly or indirectly to raise the productivity of the borrowing country and that the prospects are favorable to the servicing of the loan. The majority of the committee making the report shall consist of members of the technical staff of the Bank. The committee shall include an expert selected by the country requesting the loan who may or may not be a member of the technical staff of the Bank.

(*d*) The Bank shall make arrangements to assure the use of the proceeds of any loan which it guarantees, participates in, or makes, for the purposes for which the loan was approved.

(*e*) The Bank shall guarantee, participate in or make loans only at reasonable rates of interest with a schedule of repayment appropriate to the character of the project and the balance of payments prospects of the country of the borrower.

2. In accordance with the provisions in IV–1, above, the Bank may guarantee in whole or in part loans made by private investors provided further :—

(*a*) The rate of interest and other conditions of the loan are reasonable.

(*b*) The Bank is compensated for its risk in guaranteeing the loan.

3. The Bank may participate, in loans placed through the usual investment channels, provided all the conditions listed under IV–1 above are met except that the rate of interest may be higher than if the loans were guaranteed by the Bank.

4. The Bank may encourage and facilitate international investment in equity securities by securing the guarantee of governments of conversion into foreign exchange of the current earnings of such foreign-held investments. In promoting this objective the Bank may also participate in such investments, but its aggregate participation in such equity securities shall not exceed 10 per cent. of its paid in capital.

5. The Bank may publicly offer any securities it has previously acquired. To facilitate the placing of such securities, the Bank may, in its discretion, guarantee them.

6. The Bank shall make no loans or investments that can be placed through the usual private investment channels on reasonable terms. The Bank shall by regulation prescribe procedure for its operations that will assure the application of this principle.

7. The Bank shall impose no condition upon a loan as to the particular member country in which the proceeds of the loan must be spent; provided, however, that the proceeds of a loan may not be spent in any country which is not a member country without the approval of the Bank.

8. The Bank in making loans shall provide that:

(*a*) The foreign exchange in connection with the project or program shall be provided by the Bank in the currencies of the countries in which the proceeds of the loan will be spent and only with the approval of such countries.

(*b*) The local currency needs in connection with the project shall be largely financed locally without the assistance of the Bank.

(*c*) In special circumstances, where the Bank considers that the local part of any project cannot be financed at home except on very unreasonable terms, it can lend that portion to the borrower in local currency.

(*d*) Where the developmental program will give rise to an increased need for foreign exchange for purposes not directly needed for that program, yet resulting from the program, the Bank will provide an appropriate part of the loan in gold or desired foreign exchange.

9. When a loan is made by the Bank it shall credit the account of the borrower with the amount of the loan. Payment shall be made from this account to meet drafts covering audited expenses.

10. Loans participated in or made by the Bank shall contain the following payment provisions:—

(*a*) Payment of interest due on loans shall be made in currencies acceptable to the Bank or in gold. Interest will be payable only on amounts withdrawn.

(*b*) Payment on account of principal of a loan shall be in currencies acceptable to the Bank or in gold. If the Bank and the borrower should so agree at the time a loan is made, payment on principal may be in gold or, at the option of the borrower, in the currency actually borrowed.

(*c*) In event of an acute exchange stringency the Bank may in its judgment accept for periods not exceeding three years at a time the payments of interest and principal in local currency. The Bank shall arrange with the borrowing country for the repurchase of such local currency over a period of years on appropriate terms that safeguard the value of the Bank's holdings of such currency.

(*d*) Payments of interest and principal, whether made in member currencies or in gold, must be equivalent to the unitas value of the loan and of the contractual interest thereon.

11. The Bank may levy a charge against the borrower for its expenses in investigating any loan placed, guaranteed, participated in, or made in whole or in part by the Bank.

12. The Bank may guarantee, participate in, or make loans to international governmental agencies for objectives consonant with the purposes of the Bank, provided that one-half of the participants in the international agencies are members of the Bank.

13. In considering any application to guarantee, participate in, or make a loan to a member country, the Bank shall give due regard to the effect of such a loan on business and financial conditions in the country in which the loan is to be spent, and shall accordingly obtain the consent of the country affected.

14. At the request of the countries in which portions of the loan are spent, the Bank will repurchase for gold or needed foreign exchange a part of the expenditures in the currencies of those countries made by the borrower from the proceeds of the loan.

15. With the approval of the representatives of the governments of the member countries involved, the Bank may engage in the following operations:—

(*a*) It may issue, buy or sell, pledge, or discount any of its own securities and obligations, or securities and obligations taken from its portfolio, or securities which it has guaranteed.

(*b*) It may borrow from any member governments, fiscal agencies, central banks, stabilization funds, private financial institutions in member countries, or from international financial agencies.

(*c*) It may buy or sell foreign exchange, after consultation with the International Stabilization Fund, where such transactions are necessary in connection with its operations.

16. The Bank may act as agent or correspondent for the governments of member countries, their central banks, stabilization funds and fiscal agencies, and for international financial institutions.

The Bank may act as trustee, registrar or agent in connection with loans guaranteed, participated in, made, or placed through the Bank.

17. Except as otherwise indicated the Bank shall deal only with or through—

(*a*) The governments of member countries, their central banks, stabilization funds and fiscal agencies.
(*b*) The International Stabilization Fund and any other international financial agencies owned predominantly by member governments.

The Bank may, nevertheless, with the approval of the member of the Board representing the government of the country concerned deal with the public or institutions of member countries in its (the Bank's) own securities or securities which it has guaranteed.

18. If the Bank shall declare any country as suspended from membership, the member governments and their agencies agree not to extend any financial assistance to that country without the approval of the Bank until the country has been restored to membership.

19. The Bank and its officers shall scrupulously avoid interference in the political affairs of any member country. This provision shall not limit the right of an officer of the Bank to participate in the political life of his own country.

The Bank shall not be influenced in its decisions with respect to applications for loans by the political character of the government of the country requesting a loan. Only economic considerations shall be relevant to the Bank's decisions.

V.—*Management.*

1. The administration of the Bank shall be vested in a Board of Directors composed of one director and one alternate appointed by each member government in a manner to be determined by it.

The director and alternate shall serve for a period of three years, subject to the pleasure of their government. Directors and alternates may be reappointed.

2. Voting by the Board shall be as follows:

(*a*) The director or alternate of each member country shall be entitled to cast 1,000 votes plus one vote for each share of stock held. Thus a government owning one share shall cast 1,001 votes, while a government having 1,000 shares shall cast 2,000 votes.
(*b*) No country shall cast more than 25 per cent. of the aggregate votes.
(*c*) Except where otherwise provided, decisions of the Board of Directors shall be by simple majority of the votes cast, each member of the Board casting the votes allotted to his government. When deemed to be in the best interests of the Bank, decisions of the Board may be made, without a meeting, by polling the directors on specific questions submitted to them in such manner as the Board shall by regulation provide.

3. The Board of Directors shall select a President of the Bank, who shall be the chief of the operating staff of the Bank and *ex officio* a member of the Board, and one or more vice-presidents. The President and vice-presidents of the Bank shall hold office for four years, shall be eligible for re-election, and may be removed for cause at any time by the Board. The staff of the Bank shall be selected in accordance with regulations established by the Board of Directors.

4. The Board of Directors shall appoint from among its members an Executive Committee of not more than nine members. The President of the Bank shall be an *ex officio* member of the Executive Committee.

The Executive Committee shall be continuously available at the head office of the Bank and shall exercise the authority delegated to it by the Board. In the absence of any member of the Executive Committee, his alternate on the Board shall act in his place. Members of the Executive Committee shall receive appropriate remuneration.

5. The Board of Directors shall select an Advisory Council of seven members. The Council shall advise with the Board and the officers of the Bank

on matters of general policy. The Council shall meet annually and on such other occasions as the Board may request.

The members of the Advisory Council shall be selected from men of outstanding ability, but not more than one member shall be selected from the same country. They shall serve for two years, and the term of any member may be renewed. Members of the Council shall be paid their expenses and a remuneration to be fixed by the Board.

6. The Board of Directors may appoint such other committees as it finds necessary for the work of the Bank. It may also appoint advisory committees chosen wholly or partially from persons not regularly employed by the Bank.

7. The Board of Directors may at any meeting authorize any officers or committees of the Bank to exercise any specified powers of the Board except the power to make, guarantee or participate in loans. Such powers shall be exercised in a manner consistent with the general policies and practices of the Board.

The Board may by a three-fourths vote delegate to the Executive Committee the power to make, guarantee or participate in loans in such amounts as may be fixed by the Board. In passing upon applications for loans, the Executive Committee shall act under the requirements specified for each type of loan.

8. A member country failing to meet its financial obligations to the Bank may be declared in default and it may be suspended from membership during the period of its default provided a majority of the member countries so decide. While under suspension, the country shall be denied the privileges of membership, but shall be subject to the obligations of membership. At the end of one year the country shall be automatically dropped from membership in the Bank unless it has been restored to good standing by a majority of the member countries.

If a member country elects to withdraw or is dropped from the Bank its shares of stock shall, if the Bank has a surplus, be repurchased at the price paid. If the Bank's books show a loss, such country shall bear a proportionate share of the loss. The Bank shall have 5 years in which to liquidate its obligations to a member withdrawing or dropped from the Bank.

Any member country that withdraws or is dropped from the International Stabilization Fund, shall relinquish its membership in the Bank unless three-fourths of the member votes favor its remaining as a member.

9. The yearly net profits shall be applied as follows :—

(*a*) All profits shall be distributed in proportion to shares held, except that one-fourth of the profits shall be applied to surplus until the surplus equals 20 per cent. of the capital.

(*b*) Profits shall be payable in a country's local currency, or in gold at the option of the Bank.

10. The Bank shall collect and make available to member countries and to the International Stabilization Fund financial and economic information and reports relating to the operations of the Bank.

Member countries shall furnish the Bank with all information and data that would facilitate the operations of the Bank.

24th February, 1944.

QUESTIONS AND ANSWERS ON THE BANK FOR RECONSTRUCTION AND DEVELOPMENT.

United States Treasury, Washington, D.C.

CONTENTS.

Question 1.

On what principles will subscriptions to the capital of the Bank be apportioned among member countries?

Reply.

The authorised capital of the Bank is to be equivalent to about $10 billion, consisting of shares having a par value equal to $100,000 (II–1). The Bank is to be an international agency to whose capital all the United and Associated Nations will be expected to subscribe, although, of course, member countries cannot subscribe equal amounts. Each Government will, therefore, subscribe to a minimum number of shares to be determined according to an agreed formula.

The draft proposal sets up no necessary relationship between the capital subscription of a member country and the amount of loans which it may secure from or through the Bank. Nor is there any necessary relationship between loans made by the nationals of a member country and its subscription to the Bank. However, subscriptions of member countries will determine their relative share in the management of the Bank. An appropriate formula should, therefore, apportion subscriptions among member countries on the basis of their ability to provide capital for the Bank and the benefits they may expect to secure from the operations of the Bank. The draft proposal does not prescribe the formula for apportioning subscriptions, but states that the agreed formula shall take into account such relevant data as national income and the national trade of the member country (II–3).

The ability of a country to subscribe to the capital of the Bank can best be measured by its national income. Obviously, the great industrial countries will have to provide the greater part of the capital of the Bank. They are, at the same time, the countries that are particularly interested in the maintenance of foreign investment as lenders of funds abroad and as exporters of capital equipment.

The maintenance of a high level of international investment will contribute to the growth of world trade. All countries, even those not directly involved in international investment, will benefit from the expansion of world trade that will result from the maintenance of the large and steady investment of capital by the lending countries in the borrowing countries. The volume of foreign trade, therefore, will serve as a convenient indication of the benefit that member countries will derive from the maintenance of a high level of international investment after the war.

In testing various formulas based on these factors it was found that a fairly satisfactory apportionment of subscriptions could be secured by requiring each member country to subscribe an amount equal to 4 per cent. of its estimated national income in 1940 and 6 per cent. of its average annual foreign trade in 1934–38. It might be desirable to adjust the subscription upward or downward by as much as 20 per cent. of the amount determined by the formula where the member country and the Bank conclude that such an adjustment would be equitable.

The formula proposed is tentative. It appears approximately satisfactory, but no doubt other factors could reasonably be included. There will be an opportunity for the technical experts of all participating countries to consider modfication of the proposed formula.

Question 2.

Will capital of $10 billion be adequate for the Bank, particularly if only a small part of the capital subscription is to be paid in?

Reply.

The capital of the Bank will serve two purposes: it will be needed to assure creditors of the adequacy of the Bank's resources and to provide working capital for its daily operations.

Because the Bank's principal function is to encourage international investment by private investors, the surety aspect of the Bank's capital will be of particular importance. The Bank will encourage international investment primarily by acting as guarantor on approved loans made by private investors. The effectiveness of the Bank's guarantee must depend on the confidence of the investing public in the capacity of the Bank to meet its liabilities. It is probable that a subscribed capital of $10 billion will make it possible for the Bank to act as guarantor for two to three times this amount of loans without impairing the high quality of its guarantee.

The Bank will also require capital for making and participating in loans financed largely by private capital. Since these direct lending activities are expected to be only of secondary importance, the Bank's requirements for working capital will be comparatively small. Only 20 per cent. of the total subscribed capital will be paid initially by member countries. It is believed that the 2 billion dollars paid in as capital will provide a fund of gold and the currencies of member countries sufficient to permit the Bank to make or participate in loans in those cases in which the Bank's operations will take this form.

If the Bank should find it needs additional working capital, it would be possible to call for further payments on capital subscription, subject only to the limitation that not more than 20 per cent. may be called in any one year. However, the Bank may prefer to acquire additional funds for its operations by issuing its own debentures or by borrowing from financial institutions in member countries. As discussed more fully in the answers to Questions 9 and 16, the issuing of securities by the Bank to raise funds for its operations would be one method by which private investors could provide, through the medium of the Bank, the capital needed for international investment.

It is not intended that the entire capital should be used directly in the operations of the Bank. The tentative proposal requires that a substantial portion of the subscribed capital shall be reserved in the form of unpaid subscriptions as a surety fund for its obligations as guarantor on or issuer of securities. Since these funds are to be reserved for this specific purpose, there is no reason for imposing an unnecessary burden on member Governments by requiring full payment of subscriptions. The assurance of adequate capital desired by holders of securities guaranteed or issued by the Bank is fully provided by the obligation of member Governments to meet the unpaid portion of their subscriptions.

It should be again emphasised that the primary function of the Bank will not be to provide loans directly out of its own resources but to act as guarantor on securities sold to private investors. Whatever lending the Bank does out of its own resources, either as a participant with private investors or as the sole lender, is expected to be small relative to its operations as guarantor. For such purposes the paid-in capital of the Bank should be more than adequate.

The average annual volume of international investment by the leading industrial countries in the period from 1923 to 1937 was somewhat less than $3 billion a year. A considerable part of this, perhaps as much as one-fourth, was in the form of direct investment for which funds were generally not raised in the capital market. It is quite probable, too, that if the Bank had been in existence it would not have undertaken to guarantee or lend on some of the issues that were floated in this period. Moreover, even with the Bank in operation a considerable part of all international investment will continue to be made directly through the usual investment channels without any recourse to the facilities of the Bank. Under the circumstances it would seem to be clear that, even if the volume of international investment should be greater than in the period from 1923–37, a Bank for Reconstruction and Development with a subscribed capital of $10 billion would have sufficient resources to facilitate and encourage the maintenance of an adequate volume of international investment in the post-war period.

Question 3.

Why is it necessary to have any gold subscription to the Bank, or for the Bank to hold any gold resources?

Reply.

The Bank must hold resources that will enable it to serve the interests of borrowers and lenders. This is possible only if the Bank holds sufficient gold to acquire the member currencies it may need. An adequate holding of gold will enable the Bank to maintain the liquidity it requires for its operations.

Where the Bank participates in loans or makes loans directly it will be necessary to provide the borrower with the currencies of the countries in which it is proposed to procure the equipment and supplies. If the Bank could lend only in the currencies it holds, the borrowers would be restricted to obtaining their goods in the countries whose currencies happened to be available, even though more suitable equipment or better prices could be obtained elsewhere.

With its holdings of gold, the Bank could acquire the currency of any member country and make or participate in approved loans it would otherwise have to refuse. In this way it is possible for the Bank to avoid a type of bilateralism in capital transactions which may restrict trade and may involve uneconomical use of the borrowed money. Since the Bank is to "impose no condition upon a loan as to the particular member country in which the proceeds of the loan must be spent" (IV–7), it must hold some gold resources to enable it to implement this policy. This point is discussed more fully in the answer to Question 6.

The Bank will also need gold occasionally to compensate capital-goods supplying countries for the adverse effects on their balances of payments which may result indirectly from the Bank's loans. To produce the goods required, some countries may have to import additional raw materials. For example, if China borrows from the Bank in order to pay for electrical machinery and equipment purchased in the United Kingdom, the loan will be in sterling, but Britain may need additional dollars or Chilean pesos to buy copper. Accordingly the Bank would furnish Great Britain, on request (IV–14), with foreign exchange or gold equal to an appropriate portion of the sterling loan.

In some instances a borrowing country might find that its need for foreign exchange, other than that required to pay for equipment for the loan project, has increased as a consequence of a developmental program financed with the aid of the Bank. The construction of an electric power plant would increase imports of electrical equipment and machinery that must be paid for with foreign exchange; or the construction of a railway would temporarily require the shifting of labor from the production of export goods. Although the loan would provide the foreign exchange needed in connection with the project, so that the investment program would not directly affect the foreign exchange position of the borrowing country, the indirect effects could under some conditions temporarily disturb the borrowing country's balance of payments. Under such circumstances the Bank may provide part of a loan in gold or needed exchange as the circumstances warrant (IV–8 (*d*)), as explained in the answer to Question 19.

The Bank must also be in a position to meet its obligations promptly, regardless of the currencies in which they are due. Only in this way can the Bank retain the full confidence of private investors, which is essential to its successful operation. As guarantor on loans made to member countries through private investment channels, the Bank has a contingent liability which would come into force if the borrower defaulted. The Bank has a direct liability to the holders of securities it has issued for the purpose of raising funds for its lending operations. The Bank will, of course, have receipts as well as payments in the currencies of member countries. There can be no assurance, however, that receipts in each currency will always be sufficient for the payments that must be made in that currency. The holding of an adequate balance of gold is the best assurance that the Bank will always be in a sufficiently liquid position to meet its obligations.

For these reasons, it is necessary to provide the Bank with a balance of gold at the outset, and to assure it a flow of gold from its operations. The proposed gold subscription will not be a burden to the members. No country need provide more than 20 percent of its paid-in capital subscription in gold, and most of the countries would pay a smaller proportion, depending upon their relative gold and gold-convertible exchange holdings (II–4 (*a*)). The amount of gold payments will, of course, depend on the graduated scale adopted by agreement of the members. Assuming a 12·5 percent average, the initial gold subscriptions to the Bank would be about $250 million. Aggregate gold subscriptions of this amount would be a very small part of the gold holdings of member countries.

The Bank will be able to replenish its gold balance in various ways. Member countries must repurchase their local currency held by the Bank to the extent of not more than 2 percent annually of their paid subscriptions. However, this provision may be generally suspended for any year by a three-fourths vote and no country is required to use more than one-half the increase in its official gold holdings for this purpose (II–7). The Bank may also acquire gold through the payment by borrowers of interest and principal on the loans it makes or in which it participates (IV–10).

Every effort has been made in the proposal to avoid pressure on the gold and exchange reserves of member countries. The provisions for a moderate gold subscription and gold payments are intended solely to enable the Bank to perform the important functions for which it is to be established.

Question 4.

What is the appropriate rôle of the Bank in the field of international investment? Will the Bank compete with private financial institutions?

Reply.

The function of the Bank is to aid and encourage international investment through the customary private channels. Its appropriate sphere of activity is to assist private investors in meeting the needs of an expanding world economy. In the immediate post-war years capital will be urgently required for reconversion to peacetime production, for the reconstruction of destroyed areas, and for the development of economically backward regions. The revival of international long-term lending on an adequate scale is essential to the attainment of a high level of world trade without which world prosperity is impossible.

Private investors will be prepared to do some lending after the war. It is doubtful, however, whether unaided they will be willing to undertake more than a small part of the total investment required. In view of the losses suffered by international investors in some countries in the pre-war years, aid and encouragement will undoubtedly be necessary if adequate international long-term credits are to be provided by private investors. It is this specialized rôle which the Bank is to play. To the extent necessary, it will guarantee private investment abroad and thus encourage lending by private investors through the usual investment channels. In some instances it will lend directly out of its own resources or by participation with private investors.

Procedures will be established to make certain that the Bank does not compete with private investment agencies and does not grant loans which can be placed in the private capital market on reasonable terms (IV–6). The selection of specific methods to assure the application of this principle has been left to the discretion of the directors of the Bank.

The work of the Bank will be of great assistance to private investors. A competent committee under its auspices will investigate the loan projects for which the Bank's aid is requested. The committee will be especially concerned with the productivity of the project and with the anticipated balance of payments position of the prospective borrower. Methods will be employed to assure the use of the proceeds of the loan only for the approved purposes. The Bank will also make possible the extension of loans over a longer period than would otherwise be feasible. The schedule of repayment will thus be better adjusted to the character of the project that is financed. These services will be performed in connection with all loans guaranteed by the Bank as well as with loans in which it participates.

The Bank's operations as guarantor, participant and lender will undoubtedly encourage private investors. Its guarantee may well become the mark of a high-grade security appealing to a wide range of investors. The Bank's co-operation will be particularly necessary in the immediate post-war period when private investors may be hesitant because of the heavy losses they have suffered on international investment in the past and because of the uncertain business conditions which may be expected to prevail for some time in the future. The defaults of the past did incalculable harm in generally discouraging international investment. Good securities were pulled down with the bad, and for many years international investment was practically halted. The Bank, by reducing and sharing risks and by establishing standards for sound loans, will help to restore confidence in international investment.

Although the major part of the Bank's activities will be concerned with loans, it will also provide assistance in the equity capital market. The fact that the foreign loan capital required for a project will be available through the Bank should considerably facilitate the acquisition of the equity capital which may be necessary. Moreover, the Bank will offer active help to equity investment in two ways. It will obtain the guarantee of the national government that conversion of earnings on foreign-held equity investments into foreign exchange will be permitted. It may also participate in equity investments itself, although its aggregate participation in such securities may not exceed 10 percent of its paid-in capital (IV–4).

Question 5.

What will be the relation of the Bank to post-war relief and rehabilitation organizations?

Reply.

The Bank will not directly participate in post-war relief operations, in the sense of providing food, medicine, clothing, and other supplies needed by the stricken population of Europe and Asia. The direct relief task will require special agencies to deal with it. The United Nations Relief and Rehabilitation Administration has been established for this purpose, and its activities will probably be supplemented by private and public organizations in many countries.

The function of the Bank is to facilitate international investment for productive purposes. The loans it guarantees or makes must have favorable prospects of repayment. Without denying the urgency or importance of relief and rehabilitation, it is clear that the Bank cannot use its resources for this purpose. The Bank is to be a business institution whose resources are to be used to encourage international investment under prescribed safeguards in order to provide the necessary assurance to its creditors and shareholders.

In the immediate post-war period the Bank will facilitate the provision of capital for the reconstruction of the war-torn countries. In this way it will aid in restoring their productive equipment and will permit the resumption of normal employment for their workers. If adequate capital is available on reasonable terms the total amount of relief expenditure can be greatly reduced and the period during which relief operations are necessary, greatly shortened. It is to the general advantage that the need for and dependence upon relief aid should be terminated as soon as possible and that the normal trade relations of the countries of the world should be restored. The Bank can be extremely helpful in bringing about the conditions under which such trade relations can be resumed.

Question 6.

Will the Bank restrict member countries in their use of the proceeds of loans guaranteed, participated in, or made by the Bank?

Reply.

The draft proposal accords member countries the maximum freedom in their use of the proceeds of loans consistent with the objectives of the Bank. Member countries initiate their own projects, borrow in whatever capital markets they prefer, and buy their capital goods where they wish. The conditions imposed by the Bank in making loans are only those which are essential to protect the Bank against loss, and to reduce unnecessary disturbance to the economic life of member countries.

Each country will be free to direct investments into the type of undertaking which it regards as most important to its welfare. The facilities of the Bank will be available for industrial and commercial enterprises, as well as for government projects. However, where the borrower is a corporation or a municipality, the Bank will require the guarantee of the member government. The Bank itself will apply no other tests to a proposed loan than to determine whether it will be productive and whether it can be repaid.

The borrower may also seek to raise the funds in whatever capital market is most advantageous. It is not the function of the Bank to direct loans into one capital market or another, or to restrict the capital markets of member countries in which the borrower may obtain funds. It will merely aid the borrower by a guarantee of the loan when this is necessary to make the loan possible, if the loan satisfies the Bank's requirements.

Finally, the borrower is free to buy needed materials and equipment wherever it can procure them at the lowest cost or in the most satisfactory form. "The Bank shall impose no condition upon a loan as to the particular member country in which the proceeds of the loan must be spent." (IV–7). Where a loan is guaranteed by the Bank, the borrower is free to use the borrowed funds in any member country, provided the transfer of the funds has the approval of the countries concerned. Where a loan is made by the Bank, however, it will provide the borrower with the particular currencies required to pay for the purchases.

While the Bank will provide the loan in the foreign exchange that is used (IV–8), it need not restrict the expenditure of the loan to the countries whose currency it has available at the time, since it can obtain other member currencies by the sale of gold or foreign exchange (IV-15 (*c*)). Moreover, provision is made for assistance to the borrowing and the lending countries in securing other foreign exchange if needed as a result of the loan transaction (IV–8 (*d*), IV–14), as discussed more fully in the answer to Question 19.

In addition to the careful examination of loan projects submitted, the Bank must make arrangements to assure the use of the proceeds of any loan in which it is concerned for the purposes for which the loan was approved (IV–1 (*d*). In the case of loans made by the Bank directly, this will be done by making payments only to meet drafts covering audited expenses (IV–9). For guaranteed loans, somewhat similar procedures can be devised.

While member countries will be free to borrow and expend the proceeds of loans in any member country, the Bank does not limit the control that may be exercised by the lending and capital-supplying countries. A loan might affect business conditions in such countries by overexpanding production in boom periods or by affecting securities and foreign exchange markets. Through its member on the Bank board, a country may veto sales of securities in its markets, the transfer of borrowed funds to other countries, or the expenditure of loan funds at inopportune times (IV–8 (*a*), 13, 15). These aspects of the problem are discussed more fully in the answers to Questions 16, 17, and 19.

A veto of this kind will not be used frequently or arbitrarily, since it will generally result in a reduction of exports. A capital-producing country probably will exercise this power only when the loan would have clearly undesirable effects on its own economy. In that case the borrower, of course, is free to obtain funds and to procure equipment in some other country where conditions are more favorable or where increased industrial output is regarded as desirable. Since not all countries are in the same phase of the business cycle at all times, this should not be too difficult. In short, the borrower may secure a loan in any member country willing to lend and may spend the proceeds of the loan in any member country willing to sell the capital goods.

The provisions of the proposal are thus definitely designed to prevent the use of the Bank as a device for favoring the economic interests of any of its members to the disadvantage of others. It seeks to avoid, as far as practicable, bilateralism in capital transactions which is costly to the borrower and tends to restrict world trade. The limiting provisions included in the proposal have no other purpose than to safeguard the resources of the Bank, to assure the soundness of international investment, to permit member countries to protect their capital and exchange markets, and to prevent excessive investment during periods of business expansion.

Question 7.

How significant will the guarantee of loans be in the operations of the Bank? Under what conditions will the Bank offer its guarantee?

Reply.

The most important of the Bank's operations will be to guarantee loans in order that investors may have a reasonable assurance of safety in placing their funds abroad. In this way it is expected that the international flow of capital in adequate volume will be encouraged. In time, the guarantee operations of the Bank should help bring about the re-establishment of a ready market for foreign loans among private investors. Under any circumstances, private investors will provide the funds for loans guaranteed by the Bank, and such loans will be sold to the investing public through the usual investment channels.

Some countries, especially the larger ones, will probably be able to secure international loans in the immediate post-war period without the aid of the Bank. The Bank's guarantee, however, may be needed in other instances. First, the public may not be familiar with the position of the borrower and may be unable to determine the quality of the security. This would apply especially to smaller countries, municipalities and corporate enterprises. Second, the experience of the past two decades has brought foreign loans into disrepute among many investors. Good risks are confused with bad risks in the investor's general impression of the doubtful character of foreign loans.

Certain conditions must be fulfilled before the Bank will facilitate any loan, whether by guarantee, by participation, or by direct lending.

(1) The principal and interest must be fully guaranteed by a member national government (IV–1 (*a*)). That is, when the loan is made to a political subdivision or to a private corporation, the national government must guarantee payment in the event of default by the private debtor. This guarantee will serve as assurance that the international loan is regarded as in the interest of the borrowing country.

(2) A competent technical committee of the Bank must submit a report in favour of the loan (IV–1 (*c*)). This report will be based on an analysis of the proposed project or program and of conditions in the borrowing

country in so far as they relate to the prospects of servicing the loan. Loans will be approved only if they will serve to increase the productivity of the borrowing country and if the prospective balance of payments of the borrower is such that transfers of payments of foreign creditors seem assured.

(3) The Bank's guarantee will be given only when the borrower could not otherwise obtain funds on reasonable terms (IV–1 (*b*)), and the Bank will make reasonable terms a prerequisite to its guarantee (IV–2 (*a*)). The term of the loan must be long enough so that the annual charges are appropriate to the purposes for which the loan is made and to the prospective balance of payments of the borrowing country (IV–1 (*e*)).

(4) Finally, the Bank is to adopt procedures to see that funds loaned will not be diverted from the intended use (IV–1 (*d*)). These procedures may include such devices as inspection of construction, audit of accounts, or reports to the Bank.

The guarantee of the Bank will give the investor assurance that each loan has been thoroughly investigated to determine that it is sound from the point of view of the investor as well as the borrower. Furthermore, the borrowing country has assumed responsibility for payment of the loan. This is a responsibility to all the countries with whom it shares membership in the Bank, as well as to the lender. Finally, the resources of the Bank assure the lender that in case of default the guaranteed part of the loss will be met. The larger part of the capital of the Bank is specifically reserved in the form of uncalled subscriptions as a surety fund for this purpose.

The guarantee given by the Bank need not be the same for all loans. In some instances the Bank will guarantee in full both principal and interest payments. In others the Bank may guarantee principal or interest, or guarantee only part of these payments. The extent of the guarantee and the type of guarantee given will depend on the circumstances of the case. In general it is intended to give a guarantee sufficient to assure that the loan can be made at reasonable rates and on appropriate terms, without, however, assuming an unwarranted obligation on the Bank's part. This problem is further considered in the answer to Question 21.

Since the Bank is to be compensated for its risk in guaranteeing loans (IV–2 (*b*)), the fee paid by the borrower will depend on the type of guarantee. Thus the fee might be a single payment made at the time the loan is floated, varying with the size of the loan, its term, the extent of the guarantee and other relevant conditions. Alternatively, the fee might be made an annual charge payable at the interest dates. This fee could be based on the principal of the loan outstanding, and so would decrease as the loan is amortized. The precise methods by which the Bank is to be paid for its risk must be left to the discretion of its directors, who can adjust the terms to fit the circumstances of the particular loan.

Question 8.

Why is a substantial portion of the subscribed capital reserved in the form of unpaid subscriptions as a surety fund for the securities guaranteed or issued by the Bank?

Reply.

The guarantee operations of the Bank are intended to give assurance to private investors by reducing and sharing their risks. The Bank must also be in a position to borrow some private funds for the loans it makes or in which it participates with the public. In order to perform these functions satisfactorily, the institution must have large resources relative to its liabilities and it must be able at all times to meet its obligations as a guarantor and issuer of securities. Although a part of the subscribed capital of the Bank will be needed for current operations, a substantial portion will be required exclusively as a reserve that provides additional protection to private investors.

The ability of the Bank to engage in current operations will depend in large part on its assets consisting principally of member currencies, gold, and the securities in its portfolio. The attitude of the public to the Bank's guarantee and to the Bank's securities, however, will depend not merely on the resources it has in hand but even more on the resources it can call in as needed. As explained previously in the answer to Question 2, the unpaid portion of the capital subscription will be a surety fund that can be called for payment when funds are needed by the Bank to meet its obligations on the securities it has guaranteed or issued (II–5).

Since the capital shares are non-assessable (II–2), such a reserve can be most conveniently held in the form of unpaid subscriptions, for in this way it is possible to make stockholders subject to call in cases of emergency without increasing their total commitments. The shares are limited in liability in order that the maximum contribution of participating countries may be clear and definite at the outset. It would be possible to require full payment of subscriptions and then to employ part of the paid-up capital as a surety fund. To do so, however, would burden member nations without purpose, since the funds would be immobilized except under most unusual circumstances. Under the present provision, it should be noted, the Bank will be provided with this reserve at no current cost to the participating governments.

The unpaid capital held in reserve as a surety fund will provide assurance to the persons and institutions which have invested in the Bank's bond issues or in those which it has guaranteed. It will strengthen the Bank's position and increase its ability to assume obligations by the guarantee of securities at very moderate cost. The surety fund will give confidence to private investors and will make it possible for the Bank to raise funds from the public for its operations. Thus, the Bank should be able to carry on its operations successfully with a much smaller working capital than would be necessary if a surety fund were not reserved to meet the direct and contingent obligations of the Bank.

Question 9.

To what extent is it expected that the Bank will participate in loans placed through the usual investment channels? What disposition will be made of the securities asquired by the Bank through participation?

Reply.

The Bank would not participate in the lending activities of private investors merely for the purpose of investing its liquid assets. It would participate only when and to the extent that its participation is required to place a loan in the private capital market, the largest possible part of every loan being made by the investing public. The principle laid down in the draft proposal, that the Bank will lend only when the borrower is unable to secure the funds from private sources, holds equally for the Bank's participation in loans made by private investors (IV–1 (*b*)).

The Bank's participation in loans is likely to be most important in connection with very large ventures. The ability of private investment agencies to secure the participation of the Bank should enable them to finance larger projects than might otherwise be feasible. The immediate post-war years will see the reconstruction of vast areas devastated by war and the need for financing of such projects by relatively large loans. In some instances the security markets might be unable to absorb an entire issue and might find it helpful to have the participation of the Bank.

In addition to its services in connection with large ventures, the Bank will also participate in loans when the market is not able to absorb a new security issue in its entirety. This need may arise when credits are extended to a country, or for a project, not sufficiently familiar to the general public to have more than a narrow appeal. Furthermore, if there should be only limited demand for a security, participation by the Bank may lend some of the Bank's prestige to the issue and thus increase its marketability.

It is also reasonable to expect considerable demand from the investment market for the Bank's participation and for its own securities in periods of depressed business conditions, both for the funds which can be obtained and for the prestige of associating issues with the Bank. Although private investors are less likely to undertake specific foreign investment at such times, they will probably lend to the Bank because of its position as an inter-governmental institution and because of the opportunity which its securities will offer for diversified foreign investment. As a result the Bank will be able to tap private loan funds, making them available to foreign borrowers through direct loans and participations.

The Bank may participate only when all the conditions required for direct lending or guarantees are met. These comprise a national government guarantee of interest and principal, an investigation into the productivity of the proposed development, and reasonable terms, including a schedule of repayment, adjusted to the life and character of the project (IV–3). The Bank's participation will be indicative to the investing public that these conditions have been satisfied and that the loan is made with the aid and approval of the Bank. The Bank may participate in loans with or without guaranteeing the securities involved. If it should participate without guaranteeing the loan, the rate of interest paid to private investors would, of course, be higher than if the loan were guaranteed by the Bank (IV–3).

The securities acquired through participation will be retained in the Bank's portfolio only so long as they cannot be readily marketed. Since the Bank is not to be an institution primarily interested in investing its own funds, it will have no reason to hold these securities. They will be disposed of through the customary channels whenever private investors or investing institutions are ready to absorb additional parts of the issue. It is reasonable to assume that many securities, which for various reasons may not be immediately marketable, will become so in time. Furthermore, in order to facilitate the placing of such securities, the Bank may guarantee them (IV–5). By disposing of securities obtained through participation as rapidly as possible, the Bank will be fulfilling its primary goal of facilitating private international investment for productive purposes.

Question 10.

To what extent will the Bank engage in direct lending? Will the Bank continue to hold the securities resulting from its lending operations?

Reply.

The extent of the Bank's direct lending operations will depend on the ability and willingness of private investors to provide the capital needed for international investment. The Bank is not to compete with private investors (IV–6, IV–1 (*b*)) and it will make direct loans only when the private investment market cannot supply funds on reasonable terms even with the Bank's guarantee of the loans.

The Bank will find it necessary to make some direct loans, particularly in periods of depression, when the private capital market is likely to reduce the volume of all investments, and foreign investments especially. Since loans can be most beneficial to both borrowers and lenders in slack times, the Bank can perform a very valuable function in maintaining international investment in such periods, as explained in the answer to Question 17. The Bank's guarantee may induce more private investment abroad in periods of recession than has been characteristic of the past, so that the Bank may not be called upon to make many large loans directly. It will be available, however, to supplement private sources when they are not in a position to make desirable loans.

Doubtless some loans will be made by the Bank even in prosperous times. Investment bankers may not be interested in some small loans, for which the cost of underwriting and selling is too great in proportion to expected return. They may also be less interested in loans to small countries or small corporations abroad, whose securities would be more difficult to sell to their customers. Loans of this sort, however, may be entirely safe and extremely important to the country concerned, since they contribute to the development of its economy. By making such loans the Bank can perform an important function that would otherwise be neglected.

When the Bank lends directly it will receive the bonds or other obligations of the borrower, which it may hold in its portfolio or sell as circumstances permit. Its own funds will, therefore, be invested in direct loans for varying periods, depending upon the type of project, the credit position of the borrower, and the state of the capital market. If a loan is made at a time when securities can be readily sold in the market, the Bank may be able to sell the bonds from its portfolio rather quickly. When market conditions are unfavorable, the securities will have to be held for longer periods. Although this would not be the policy of the Bank, it may be compelled to hold some securities to maturity.

Sooner or later the Bank should be able to sell the larger part of its portfolio investments to private lenders on reasonable terms. Its procedure would be roughly analogous to that of the Reconstruction Finance Corporation, which took the bonds and notes of local authorities and held them until the market situation had improved sufficiently for private investors to absorb the securities. This method not only provided funds needed for important local public works, which could otherwise not have been secured on the market, but also yielded the Reconstruction Finance Corporation a fair return on its investment. In the case of the Bank, the marketing of the securities can be facilitated by guaranteeing the issue at the time of sale.

As an alternative to sale of the obligations of the borrower, the Bank may issue its own securities (IV–15) and sell them to private investors, using the proceeds to make loans to member countries and holding the borrowers' obligations. In this way the Bank can consolidate a number of relatively small loans into a single marketable issue. Moreover, the Bank's direct obligations may be viewed more favorably by investors than the bonds of borrowers in some member countries, even though guaranteed by the Bank. The policy of the Bank would be to secure from private investors the greater part of the funds it lends directly. The Bank's own securities would, of course, be sold through the usual investment channels.

Question 11.

Will it be possible to utilize the facilities of the Bank to meet needs for local funds by securing an international loan and converting the proceeds into local currency?

Reply.

Borrowers through or from the Bank will not be able to use its facilities to raise local funds except under special circumstances. In general, the Bank is not intended to provide funds for expenditure within the borrowing country, even in the case of projects for which the foreign exchange needs are financed largely by the Bank (IV–8 (*b*)).

The Bank will not compete with the capital markets or commercial banks of the member countries in providing local funds for investment. In its lending operations it will provide an amount sufficient only for the necessary foreign purchases in the specific currencies required (IV–8 (*a*)). It will be further safeguarded by the regulations governing the use of proceeds of loans. They are to be placed in an account, with withdrawals permitted for drafts covering audited expenditures (IV–9).

As a rule, a borrower should obtain the local funds needed for an investment project from its own capital markets and should not depend on foreign loans to meet the need for local funds. It is generally a grave error to burden the balance of payments of a country with the servicing of a foreign loan when the needed capital can be raised at home. The facilities of the Bank should not be used for local financing, although indirectly the availability of international credits will help a borrower in securing supplementary local funds. In the case of a project undertaken by a private enterprise, the funds will probably be obtainable from the sale of shares or bonds within the borrowing country. The raising of local capital by a government or a private business concern will be facilitated by the knowledge that the Bank will provide the foreign exchange required in connection with the project.

There will be occasions, however, when the Bank will find it desirable to make part of a loan in local currency. It will be prepared to do so when it finds that the domestic expenditures needed cannot be financed at home (IV–8 (*c*)). Such a situation may arise when the amount to be spent locally is relatively large and facilities for borrowing from private investors or from banks are undeveloped. Of course, where a developmental project will temporarily disturb the balance of payments position of a country, the Bank will provide for the foreign exchange needs which are an indirect result of the investment even though local expenditures bring about this temporary disequilibrium. Satisfying these requirements, however, will not generally entail the provision of foreign exchange to meet needs for local funds.

In the exceptional circumstances where the Bank decides that it is necessary to provide some of the local funds in connection with a developmental project, it would not in fact be necessary ordinarily to convert foreign exchange into local currency. This is certainly true of loans made directly by the Bank. The foreign exchange markets would not be affected when the Bank makes part of a loan in local funds, for the Bank would lend that portion to the borrower out of local funds held by the Bank (IV–8–(*c*)). Under any circumstances, if exchange transactions becomes necessary in connection with loans through or by the Bank, they can be undertaken only with the approval of the countries concerned (IV–15–(*c*)). A fuller discussion of this point will be found in the answer to Question 19.

Question 12.

What assurance is there that international lending will be on a sounder basis because of the operations of the Bank?

Reply.

The operations of the Bank may be expected to have a wholesome effect on international investment by restoring the confidence of private investors in foreign securities. Although the Bank would not prevent loans from being granted on any basis agreeable to the parties concerned, the operations of the Bank would, nevertheless, tend to improve the quality of foreign loans.

It is reasonable to assume that the standards established by the Bank for its own lending activities will, over a period of time, have an effect on the attitude of private investors. These standards will focus attention on the importance both of the productivity of the project being financed and of a prospective balance of payments in the borrowing country favourable to servicing the loan. Emphasis will also be placed on a schedule of repayments appropriate to the life and character of the project. The written report of a competent technical committee, having no vested interest either as lender, borrower or intermediary, required by the Bank prior to the approval of loans, will help to assure the fulfilling of these conditions established for the protection of the investor.

The revival of international investment in amounts commensurate to the task depends upon the restoration of the confidence of private investors in foreign issues. It is unfortunate that in this country private investors have failed to discriminate sufficiently in the past between good and bad risks. The substantial losses which they suffered undoubtedly affected adversely international lending as a whole. The example of loans properly safeguarded should encourage private capital to go into international investment after the war.

The emphasis placed by the Bank upon the importance of reasonable conditions for international investments should also contribute to greater security on international loans. Too often loans bearing very high interest rates and short terms of repayment resulted in severe losses to investors. Such loans carried a deceptive compensation for risk, since the terms on which they were granted made repayment difficult. To this must be added the feeling of some borrowers that the terms were too onerous to meet. International investment can be maintained at a high level only if defaults are minimized. The Bank has the duty to protect both the borrower and the lender by stressing the necessity of high standards and reasonable terms on foreign securities. International investment can be maintained only when lenders and borrowers secure advantages from international investment.

Moreover, as discussed in the answer to Question 13, the Bank will have an overall picture of the loans contracted by a borrowing country which will be useful in discouraging excessive extensions of credit. Loans made with the Bank's assistance will also be safeguarded against default because failure to pay interest and principal on loans guaranteed or made by the Bank may cause it to suspend the defaulting country. Since the other member governments and their agencies agree not to extend financial assistance to a suspended country without the approval of the Bank (IV–18), the inducement to continue servicing loans, even at some sacrifice, will be very great.

Finally, the Bank may be able to co-ordinate its lending policies to prevent large fluctuations in international investment. It will undoubtedly be able to effect a net increase in foreign investment during periods of depression, and it may also be instrumental in preventing excessive expansion resulting from international loans in a country experiencing a boom. The problem is considered in greater detail in the answer to Question 17.

Question 13.

Will the Bank be able to prevent the excessive extension of credit to member countries?

Reply.

One of the difficulties in connection with international investment in the past has been the tendency to extend excessive credit to some borrowing countries. No satisfactory quantitative test can be set up to determine whether an excessive amount of credit is extended to a borrowing country. The practical test must be this simple objective one: Can a borrowing country, including its political subdivisions and business enterprises, meet the servicing requirements of their foreign obligations even in periods of business recession? If they can, the conclusion must be that credit has not been over extended.

A number of provisions in the tentative proposal are designed to assure that on loans made through or by the Bank interest requirements and repayments of principal will be met. The underlying purpose of these safeguards is to protect the investor from making excessive loans and the borrower from undertaking excessive obligations. It is to the interest of both borrowers and lenders that aggregate international investment be maintained on a remunerative basis to induce private investors to continue to provide an adequate supply of funds for productive projects in borrowing countries.

The default of a foreign loan may come about because the borrower cannot obtain the local funds required for the debt service or because it is unable to arrange the transfer to the external creditor. To avoid these difficulties, the tentative proposal provides that no loan may be guaranteed, participated in, or made by the Bank unless a competent technical committee has made a careful study of the merits of the project or the program, and concludes, in a written report, that the loan would serve to raise the productivity of the borrowing country and that the prospects are favorable to the servicing of the loan (IV–1 (*c*)). Emphasis is placed on the productivity of a loan, for it is the basic safeguard that a loan will provide the local funds or the foreign exchange required to service the debt.

It should be noted that one requirement on loans made through or by the Bank is that the national government must fully guarantee the payment of interest and principal on loans to political sub-divisions or business enterprises in the country (IV–1 (*a*)). One purpose of this provision is to secure the definite commitment of the national government to the transfer of funds for servicing the loan. A specific requirement to this effect is made in connection with equity securities that are placed with the aid of the Bank (IV–4).

If a loan is productive, the nation's capacity to produce will be increased and its capacity to develop a balance of payments surplus may also increase. Loans made for the development of the export industries directly will be most effective in this connection. Similarly, loans which diversify the commodity exports of a country may be expected to reduce the danger of adverse market conditions which sometimes burdened the single crop exporting countries in the pre-war period. It is not at all essential, of course, for a loan to be directly related to foreign trade, provided it is productive and the prospective balance of payments position of the country is favorable to the servicing of the loan.

No simple criterion can be used in determining whether the balance of payments position of a country will be favorable to the servicing of its foreign debts. There have been countries, such as the United States, which for long periods were borrowers abroad with a persistently adverse balance of payments on current account, although in part this adverse current balance was a reflection of their position as borrowers for investment purposes. In considering the capacity of a country to service foreign investments, the prospective balance of payments is more significant than the present balance of payments. Countries with a relatively large and growing export trade may be regarded as in a favorable position to serve their foreign debts, even if for the time being they show an adverse balance on current account. In some borrowing countries tourist trade and other invisible items will be an important source of foreign exchange and should be considered along with exports in determining the prospects for servicing foreign investments.

In considering the prospective balance of payments of a borrowing country, emphasis should be placed on aggregate foreign exchange receipts rather than on its net balance of payments. So long as a country has a flow of foreign exchange it can meet its contractual obligations, although at times this might necessitate a reduction of its imports. Where a country's imports do not consist predominantly of food and raw materials, a reduction in imports relative to its imports can be brought about through changes in the consumption pattern of the country. However, even in such a case there is some limit to the extent to which imports can be reduced in an emergency, and for this reason annual foreign requirements for debt servicing should not become too large as compared with gross foreign exchange receipts.

The technical committee of the Bank would undoubtedly take all such factors into consideration in determining whether the prospects are favourable to the servicing of a loan guaranteed, participated in, or made by the Bank. Obviously estimates of such matters must remain judgments made in the light of a continuously changing world economy. The judgments of the Bank directors, however, based as they will be on the careful consideration of all the relevant economic factors, are likely to be better than has been characteristic of judgments on the soundness of investments in the past. When unpredictable circumstances make it impossible for a country to meet its foreign obligations for short periods, the Bank may accept a local currency for periods of three years (IV–10 (*c*)).

Careful investigation along the lines suggested above should help prevent the extension of unduly large credits to member countries by or through the Bank. Undoubtedly, the action of the Bank will affect the attitude of private investors. When the Bank limits its loans to a particular country or refuses to guarantee further issues, it is likely that private investors will be less ready to lend to that country. In the case of member countries which do not require assistance from the Bank, the Bank will probably have no control over the amount of their borrowing or the purpose for which the credits are used. These, however, will be the countries whose loan records in the past indicate care in not over-extending their obligations.

Question 14.

What reason is there for the Bank to facilitate loans which private investors are not prepared otherwise to make?

Reply.

There are occasions when the Bank may properly facilitate loans to a borrower even though private investors would be unwilling to invest in such loans without the guarantee of the Bank. It is quite apparent from the experience of the 1920's that private investors are not always right in their evaluation of foreign loans. Just as they have at times made bad loans, so at other times they have refused to make sound loans. Lack of knowledge may make proper evaluation of foreign securities difficult for private investors.

The Bank, on the other hand, will have more complete knowledge of foreign investments and adequate facilities for the investigation of every loan placed with its assistance. A competent committee of experts will report on the productivity of the project and on the prospects for servicing the investment (IV–1 (*c*)). Assurance will be required that the proceeds of the loan will be utilised only for the approved purpose (IV–4 (*d*)), and the national Government guarantee will provide additional protection (IV–1 (*a*)). The Bank will be in a position to make judgments based on a fuller understanding of the facts and it will also be able to secure safeguards not available to private investors.

There is, furthermore, no reason to assume that the legitimate need for capital will always be met in full by private investors. The fact that funds are not available at a given time cannot be interpreted as evidence that the private capital market is unwilling to lend because the securities are poor risks. General market conditions, rather than the soundness of specific securities, are often the predominant factor in determining the volume of lending. Investors have loaned freely in boom years without regard to the merits of the investment or the prospects of repayment. They have been reluctant to lend in periods of depression even to borrowers of high standing. The great variation in the volume of foreign investment is evidence of the importance of factors not related to the merits of individual projects requiring capital.

Changes of considerable amplitude in the volume of foreign lending occurred even during the prosperous years of the 1920's. For example, gross long-term foreign lending in the United States rose from \$1·2 billion in 1925 to \$2·1 billion in 1928. A major decline occurred during the period of depression when gross long-term foreign lending fell to less than \$300 million in 1932. It should be noted that during this period of depression net foreign investment was actually negative because of the repatriation of American capital and the flight of foreign capital to this country.

The sharp decline in foreign investment during the 1930's is not an indication of the absence of opportunities for long-term productive investment. It is evidence, however, of the fact that at certain times private investors cannot be expected to lend abroad. In such periods even the best borrowers must go begging. If the legitimate needs of countries for capital imports are to be met regularly and with good prospects of repayment, an international institution capable of aiding and supplementing private investors is necessary.

It is a mistake to think of countries simply as good or bad risks for international loans. Every country is a sound risk for loans in limited amount for productive purposes. While private investors cannot assure themselves that the loans they make, though sound at the time, will not be impaired by excessive borrowing at a later time, the Bank is in a position to prevent such a development. It can keep the amount of loans made through or by the Bank at a conservative level, and make certain that such loans are used exclusively for productive purposes. Furthermore, as explained in the answer to Question 15, an international agency is in an especially favourable position for seeing that obligations on loans made through or by it are met by the borrowing countries.

Question 15.

Why is an international agency necessary to encourage and facilitate the provision of long-term credits for international investment?

Reply.

There seems to be wide agreement that encouragement and aid is necessary if an adequate volume of international investment is to be maintained after the war. There has been some question whether an international agency is best suited for this purpose.

The provision of long-term international credits affects every aspect of international economic relations. Unless an adequate supply of capital for international investment is available, it will be difficult to maintain the balanced growth of international trade. International investment facilitates the maintenance of equilibrium in the balance of payments and thus helps to stabilise exchange rates. Furthermore, world-wide fluctuations in business conditions are to a considerable extent the result of large fluctuations in international investment. An international problem, so broad in scope and with such wide ramifications, can best be handled through an international agency such as the proposed Bank.

International investment is not confined to any one country. The large industrial countries of Europe as well as the United States have played an important rôle in the provision of capital for international investment. No doubt, as the result of the war other countries, such as Canada, will for the first time become important sources of capital for international investment. The resources available for encouraging international investment can be most effectively used through an international agency embracing all countries.

The risks of holders of securities guaranteed or issued by an international agency are shared by all of the participating countries. The creditors on securities issued through or by the Bank would in a real sense include all of the participating countries who are guarantors of securities through their subscription to the Bank. A default on such securities becomes a default on a general international obligation to many countries and the measures that may be applied to the defaulters would be applied by all member countries.

If national agencies should be established generally for the purpose of encouraging international investment it is doubtful whether countries could altogether escape the use of their lending agencies for the purpose of furthering national political interests. The extension of credit to a particular country becomes a political matter to be settled by negotiation between the borrowing country and the lending country. Even if such political considerations could be kept to a minimum, it is doubtful whether national agencies would be as helpful as an international agency in developing international trade and removing the restrictive bilateralism that grew up in the decades before the war.

The provisions of the Bank proposal are designed to safeguard the national interests of member countries. No loan can be made nor can any securities be sold by the Bank in a member country without its approval. No exchange transactions can be undertaken in the currency of a member country without its approval. These provisions are intended to make sure, as explained in the answers to Questions 16 and 17, that the operations of the Bank do not adversely affect the capital, money and exchange markets, or business conditions in member countries. The determination of policy on these matters is completely reserved to each member country.

An international agency working in co-operation with national authorities can be most effective in encouraging private investors to resume international investment and provide adequate capital for productive purposes. The operations of such an agency can do much to contribute to a higher level of world trade, a greater degree of stability in exchange rates, and fuller employment in all member countries.

Question 16.

How will it be possible to prevent the operations of the Bank from having an adverse effect on the security markets and money markets of member countries?

Reply.

The provisions of the proposal for a Bank are designed to prevent disturbances in the security markets of member countries as a result of its operations. Each member country has a safeguard against undesirable action in the requirement that securities may be sold in its markets only with the consent of its representative on the Bank board (IV–15 (*a*)).

In its operations the Bank proposes to utilise as fully as possible the facilities of the investment markets. It is expected that its main function will be to guarantee securities representing productive loans made in the usual way by private investors to member countries, their political subdivisions or business enterprises. As explained in the answer to Question 10, even when the Bank lends directly to borrowers in member countries, it will receive the borrowers' obligations and hold them for subsequent sale through the usual investment channels when market conditions permit. If the Bank issues its own obligations to secure funds, it will also dispose of them through the investment market.

Because the Bank's operations are intended to assure the provision of investment funds directly or indirectly through the capital market, it is essential that the operations of the Bank should not have disturbing effects on the security markets. The Bank itself will undoubtedly be concerned to see that the foreign loans it facilitates do not deprive domestic borrowers of the funds they need for domestic investment. In the last analysis, however, dependence must be placed on the member country to inform the Bank when its operations have an undesirable effect on the capital market. In accordance with IV–15 (*a*) and other provisions, member countries can prevent the sale in their markets of securities originating from the Bank's operations.

It is conceivable, too, that the operations of the Bank could affect the money markets of member countries. This would be particularly true of the direct loans of the Bank, if the Bank's holdings of a member currency were kept as a deposit with the Central Bank. Under such circumstances, the expenditure of a loan made or participated in by the Bank would result in an increase in the reserves of the commercial banks. Similarly, the payment of interest or principal on securities held in the Bank's portfolio would tend to decrease the reserves of the commercial banks.

There is still another way in which the operations of the Bank could affect the money markets of member countries. If the securities guaranteed by the Bank or issued by the Bank were bought or sold in any considerable volume by commercial banks it would, of course, increase or decrease the volume of deposits and affect inversely the volume of excess reserves. Under such circumstances, the availability of bank funds for domestic borrowers would depend in part upon the attitude of the commercial banks towards securities guaranteed or issued by the Bank.

Obviously, every effort should be made by the Bank in its operations to avoid any direct effect on the money markets of member countries. Monetary policy must remain wholly within the control of the national monetary authorities. The Bank can minimize the effects of its operations on the money markets by predominant use of guaranteed loans rather than direct loans out of its own funds. Furthermore, securities guaranteed or issued by the Bank should be sold as far as possible to private investors rather than commercial banks. The Bank would, of course, co-operate with the Central Bank and the monetary authorities of a member country so that its operations would not offset measures intended to make the monetary policy of the country effective. Under any circumstances, it is within the power of a member country to prevent the Bank from guaranteeing, participating in, or making any loan in its currency without its consent (IV–13).

Question 17.

How will it be possible to prevent the operations of the Bank from intensifying the effects of excessive investment in boom times and deficient investment during depression?

Reply.

The operations of the Bank in facilitating international investment are certain to affect business conditions in the borrowing and lending countries and, indirectly and to a lesser extent, in other countries. It is important, therefore, that the operations of the Bank should not be of a character tending to accentuate the forces of expansion during boom or the forces of contraction during depression. On the other hand, the Bank can aid considerably in stimulating production in periods of business depression and it can co-operate with central banks and governments in their attempts to check excessive expansion in periods of business prosperity.

The expenditure of the proceeds of international loans, whether made by private investors or by the Bank, will affect production in the country receiving the loan as well as in the country supplying capital goods. An international loan for the purpose of acquiring capital equipment abroad will generally tend to encourage domestic expansion. The investment project for which the foreign loan is made is certain to involve in part domestic outlays for labor and local materials, even if much or all of the essential equipment comes from abroad. The effect will be to increase the income and expenditure of domestic labor and so contribute to industrial expansion.

The loan will also stimulate an expansion of production in the countries supplying the capital goods. The production of new capital equipment will require additional labor and raw materials. The increased employment in heavy industry will in turn increase the demand for consumer goods. The effect of international investment on business conditions is particularly important since the heavy industries are subject to rather extreme fluctuations in the demand for their products.

The effects of foreign investment are obviously not entirely confined to the borrowing and lending countries. The higher level of employment and income resulting from such investment necessitates increased imports of raw materials for production and finished goods for consumption. The aggregate volume of foreign trade is increased and all countries engaged in foreign trade feel the indirect effects of international investment.

Because of its importance, it is desirable to prevent excessive fluctuations in the aggregate volume of international investment. It would be most unfortunate if the operations of the Bank were to result in excessive international investment during a period of world-wide prosperity and a sharp contraction of international investment during a period of world-wide depression. Large fluctuations in international investment in the 1920's and 1930's undoubtedly contributed to the sharp decline in international trade and to the severity of the depression in the 1930's.

The problem of maintaining international investment at an appropriate level is not only concerned with the aggregate amount of international investment but also with its distribution among member countries. The great industrial countries, which are the principal source of funds for foreign investment and the principal producers of capital goods, are themselves subject to booms and depressions of large amplitude related to fluctuations in the volume of domestic investment. The operations of the Bank must be co-ordinated with business conditions in such countries. For obvious reasons, domestic investment must be given precedence.

The international character of the Bank is particularly important in relation to the maintenance of adequate but not excessive international investment through the course of the business cycle. Business is not always in the same phase of the cycle in all countries. The Bank can avoid accentuating a boom in a capital-producing country by directing loans to other countries with available labor and unused industrial capacity. Moreover, by encouraging international investment at the beginning of a recession the Bank may aid in avoiding a more serious break-down, which would have world-wide repercussions.

The Bank itself will undoubtedly take into consideration business conditions in the lending and borrowing countries when passing upon applications for loans to be guaranteed or to be made by the Bank. The primary dependence on private investors for loanable funds will to some extent tend to check excessive investment in periods of expansion, for at such times interest rates will tend to be relatively high. However, complete reliance cannot be placed in such checks, as previous experience has proved. The Bank should determine its policy on international lending with reference to world-wide business conditions. It should maintain the closest co-operation with the Central Banks and the monetary authorities of member countries. Ultimate responsibility to assure that international investment does not induce excessive expansion in a member country must depend on its own monetary authorities. Under the provisions of the proposal the Bank must give due regard to the effect of a loan on business and financial conditions in the country in which the loan is to be spent and must obtain the consent of the country affected (IV–13).

Question 18.

What will be the relationship between the proposed Bank and the International Stabilization Fund?

Reply.

The Bank and the International Stabilization Fund are both needed to help solve the international monetary and financial problems that will confront the world in the period after the war. While the two agencies will co-operate with each other in many ways, each has distinct functions of its own to perform. The Fund has been specifically designed to promote currency stability, whereas the Bank is intended to facilitate international investment for productive purposes.

The establishment of the Bank would simplify the task of the International Stabilization Fund, and the successful operation of the Fund would enhance the effectiveness of the Bank. The existence of one, however, is not essential to the other. Each could stand and function alone; together, they could make a significant contribution to the development of world prosperity. Membership in the two agencies has, therefore, been related. Countries must be members of the Fund before they subscribe to the shares of the Bank (II–3), and any country which withdraws or is dropped from the Fund will also relinquish membership in the Bank unless three-fourths of the member votes favor its remaining as a member (V–8). It is expected that all the United and Associated Nations will participate in both organizations.

Although each agency could exist alone, the establishment of the Bank and the Fund would be helpful to both institutions, and would facilitate their successful operation in the immediate post-war period and the years thereafter. The loans made with the assistance of the Bank will expand the volume of foreign trade and thus improve the opportunity for all countries to maintain a balanced position in their international accounts. The extension of long-term credits will be less variable, as explained in the answer to Question 17, and the existence of the Bank should help prevent the reappearance of the large unstable short-term indebtedness which was in part a result of an unwillingness to invest at long-term, as explained in the answer to Question 19. The Fund, in turn, will decrease the risks of foreign investment by minimizing disorderly fluctuations in exchange rates which have discouraged long-term foreign loans. It will help to eliminate foreign exchange restrictions which, by preventing the withdrawal of income earned on investments, have seriously deterred international lending.

In the course of carrying on their separate activities the Bank and the Fund will cooperate and consult with each other on matters of joint interest. The Bank may find it necessary on occasion to buy or sell foreign exchange as part of its operations. It will undertake such transactions after consultation with the International Stabilization Fund and only with the approval of the countries concerned (IV–15 (*c*)). Furthermore, in so far as the Bank converts gold into member currencies needed for its operations, it may choose to do so through the Fund.

It is clear that the two major financial problems of the post-war period are closely interrelated. Currency stabilization cannot be completely separated from the provision of long-term international credits. The two institutions designed to deal with these problems will find that cooperation between them is essential. Together, they can help to provide a sound financial foundation for a prosperous world economy.

Question 19.

Will the Bank's operations facilitate the maintenance of equilibrium in the balance of payments and thus help to stabilize exchange rates?

Reply.

The operations of the Bank will generally contribute to the maintenance of equilibrium in the balance of payments of both lending and borrowing countries.

Short-run equilibrium in the borrowing country is facilitated because international loans enable it to purchase capital goods on credit, where it might otherwise be compelled to employ an excessive part of its gold and foreign exchange resources to pay for such imports. International investment helps prevent the development of pressures on the exchanges that might necessitate exchange control and similar restrictive measures designed to force a balance in a country's international accounts or an undesirable alteration in exchange rates to offset a temporary disequilibrium.

Long-run equilibrium in a borrowing country's international accounts is facilitated by investments that increase its productivity and capacity to export relative to its import needs. For example, international investment for the development of the iron ore deposits of Brazil or the petroleum resources of Venezuela and Colombia will increase the exports of these countries, with the proceeds available for both debt servicing and additional imports. One of the most difficult problems of some debtor countries has been the great fluctuation in their foreign exchange receipts resulting from excessive dependence on one crop. Loans which would diversify their output and their exports would clearly be helpful in maintaining a greater degree of equilibrium in their balance of payments.

Foreign loans extended for the purchase of capital equipment will help restore equilibrium in the balance of payments of a country whose current accounts are already favorable. Some exports of capital equipment that would otherwise have been paid for by an inflow of gold or the accumulation of balances abroad would be paid for with the proceeds of the loan. Furthermore, foreign investment by a country with a favorable balance of payments will increase exports, production, and income at home, and bring about an increase in imports of raw materials and consumption goods which will contribute further to the balancing of its current international accounts. In the long run, the maintenance of equilibrium in the balance of payments of the capital-exporting country must depend on the adjustments in reciprocal demand that grow out of the development of the productive resources of the borrowing countries.

Where a loan is made in one country and expended in others, the transaction could be disturbing to the foreign exchanges if the favorable balance of current account of the lending country were less than its new foreign investment. The draft proposal safeguards against such a development by providing that the Bank must take into consideration the effect of a loan on financial conditions in the lending country and must obtain the consent of the country concerned (IV–13). Furthermore, the Bank may not buy or sell foreign exchange except with the approval of the countries concerned (IV–15 (*c*).

Countries not directly concerned as borrowers or lenders are also likely to benefit from a larger volume of international investment. As explained in the answer to Question 17, the level of production and income in the borrowing and lending countries will rise with more international investment. At the higher level of production and income, their imports will also increase. All other countries not directly concerned as borrowers or lenders will be affected by the increased demand for their export goods and will consequently find their balances of payments on current account more favorable than they would otherwise be.

Although the general effect of international investment is to facilitate the maintenance of equilibrium in the balance of payments on current account, there may be some instances in which this will not be so. Where investment is undertaken with the aid and encouragement of the Bank, provision is made to offset the resulting adverse effects on the balances of payments of the member countries concerned.

If long-term credits are extended by a member country with an unfavourable balance of payments, the loan may temporarily increase the disequilibrium in its position. Of course, the loan may result directly in an increase of an equal amount of exports and this will tend to limit the adverse effect on the balance of payments. Furthermore, the Bank will repurchase for gold or foreign exchange a part of the local currency spent in the lending country (VI–14). With the application of this provision, a country will find that its balance of payments will not deteriorate as a result of loans made through or by the Bank. Again, it should be emphasized that loans cannot be made through or by the Bank without the consent of the country concerned (IV–13).

The Bank's assistance may also be needed to help maintain equilibrium even when a lending country invests abroad no more than its favorable balance on current account. Increased exports of capital goods stimulated by long-term lending may increase the level of production and income in the lending country, with a consequent rise in imports of raw materials and consumers' goods. This indirect effect on the balance of payments is the same whether or not the Bank is a guarantor or participant in an international loan. However, in the case of loans through the Bank, the exporting country will be protected against difficulties of this kind by the provision that the Bank will repurchase for gold or foreign exchange a part of the local currency spent in the lending country.

Provision is also made to offset any tendency to increase disequilibrium in the balance of payments of the borrowing country which may temporarily arise as a result of loans through the Bank. A country importing capital for a developmental program may find its trade position impaired for a short period because of augmented imports induced by a rise in the national income or by the diversion of labor to the new project which necessitates imports to compensate for decreased consumers' goods output. A nation undertaking extensive capital improvements may also for a time divert capital and labor from the export trades. Obviously, the pressure on the balance of payments from such forces must be of a temporary character or there would not be a sound basis for extending foreign loans. The Bank in making loans agrees that " whenever the developmental program will give rise to an increased need for foreign exchange for purposes not directly related to that program yet resulting from it, the Bank will provide an appropriate part of the loan in gold or desired foreign exchange " (IV–8 (*d*)).

Special consideration is given to the problem of servicing of loans made with the Bank's assistance so that it will not cause disequilibrium in the borrower's balance of payments. Protection is given through the requirement that loans must provide for a schedule of repayment appropriate to the character of the project and the balance of payments prospects of the borrower (IV–1 (*e*)). To the extent that the debt service is geared to the life and nature of the capital project, repayment will be feasible out of the increased productivity and export surplus resulting from the loan, without straining the country's balance of payments. In the event of an exchange stringency the Bank may permit payment of interest and principal in local currency for periods not exceeding three years (IV–10 (*c*)). To protect the Bank, the borrower must arrange for the repurchase of such currency.

The Bank will improve the general prospects for achieving equilibrium in the balances of payments of the major trading countries by preventing drastic declines in the total volume of foreign lending. There can be no doubt that the general effect of international investment is to help maintain equilibrium in the balance of payments of debtor and creditor countries; but when the world has become adjusted to a given level of international investment, a large and sudden reduction in the volume of international investment can be extremely disturbing. The Bank can help to maintain a greater degree of stability in the provision of capital for international investment.

Question 20.

What provision is made to assure the Bank against loss from exchange depreciation? What provision is made to prevent undue hardship to member countries during a period of exchange stringency?

Reply.

The draft proposal provides that the member countries must guarantee the Bank against loss on its holdings of local currencies (III–2). If a member country reduces the value of its currency in terms of gold, it is required to compensate the Bank for the loss by delivering an additional amount of local currency, so that the gold value of the Bank's holdings of local currency after depreciation will be the same as before. A considerable portion of the Bank's capital, from 80 to 90 percent, will be paid in member currencies, and the Bank will acquire additional amounts in the course of its business. To enable it to fulfill its own obligations, the Bank must be protected against the loss which would result from a member's depreciating its currency with respect to gold.

Certain other provisions of the Bank proposal will tend to protect the Bank against currency depreciation. Each member country is to be required to repurchase annually with gold an amount of its local currency equal to 2 percent of its paid-in subscription (II–7), provided that this amount does not exceed half of the gold acquired by the member in the course of the preceding year. This provision will allow for a gradual retirement of the local currency paid on subscriptions to the Bank.

Although the Bank is not to be concerned directly with the maintenance of exchange stability, its operations are designed to avoid disturbing established exchange rates. In order to guarantee, participate in, or make a loan in a specified currency, the Bank must secure the consent of the country concerned. This consent can be withheld if in the judgment of the member country the loan would adversely affect its foreign exchange position (IV–13). Furthermore, the Bank may not buy or sell foreign exchange except after consultation with the International Stabilization Fund and with the consent of the countries whose currencies are involved (IV–15 (*c*)).

Direct loans by the Bank will be made in the member currencies needed for obtaining the capital goods required, so that as a consequence there should be no great disturbance of the exchanges of either the borrowing country or the capital-supplying country. Payments of interest and principal must be made by the member country in foreign exchange acceptable to the Bank or in gold (IV–10 (*a*), (*b*)). At the time the loan is made the Bank and the borrower may agree to payments in the currency actually borrowed. In either case the Bank is to be protected by the borrower against exchange depreciation (IV–10 (*d*)).

While the Bank proposal contains ample safeguards against losses from exchange depreciation, it will permit some flexibility in periods of emergency. It must be recognised that even with the International Stabilization Fund and the Bank in operation, some countries may get into temporary exchange difficulties. In such cases the Bank is to be authorized to accept local currency in payment of interest and principal, instead of the required gold or foreign exchange. This privilege is to be extended by the Bank to a borrowing country for periods not exceeding three years (IV–10 (*c*)). The borrower is to be allowed a period of several years in which to repurchase this local currency under an agreement that safeguards the value of the Bank's holdings.

The Bank proposal contains other provisions designed to prevent pressure upon member countries during a period of exchange stringency. For example, the requirement that each member country shall repurchase annually with gold an amount of its local currency equal to 2 percent of its paid-in subscription is qualified by the provision that no country is to be required to repurchase local currency in excess of one-half of the addition to its official holdings of gold during the preceding year (II–8 (*b*)). Moreover, the Board by a three-fourths vote may suspend this requirement for any year (II–8 (*a*)). This safeguard would be available for use in a general emergency when it is desired to avoid pressure on the gold reserves of member countries.

As discussed more fully in the answer to Question 19, the position of borrowing and lending countries is safeguarded by the provision that where an indirect need for foreign exchange arises as a result of loans made through or by the Bank, the Bank will provide part of the loan in gold or foreign exchange (IV–8 (*d*); IV–14). By providing exchange for needs arising indirectly from international investment, the Bank will prevent its operations from disturbing exchange rates as much as possible; and member countries will not find their exchange position impaired as a result of the operations of the Bank.

Question 21.

Will the rate of interest be uniform on loans guaranteed, participated in, or made by the Bank?

Reply.

The rate of interest on loans through the Bank will vary with the conditions of the financial markets and the credit position of the borrower. The basic consideration to be taken into account is that the Bank will not guarantee, participate in, or make loans where the borrower can obtain funds from other sources under reasonable conditions (IV–1, 6). Quite obviously, some governments, municipalities or business enterprises will be able to borrow in international markets at reasonable rates without the Bank's assistance.

Loans will be made through the Bank only when prospective borrowers are not able to obtain funds on reasonable terms. Since the Bank must be compensated for its risk as guarantor and must also earn a fair return on its direct loans, the rate of interest to borrowers of this type will be higher than that paid in the market by borrowers who do not need the Bank's assistance. In general, the Bank will be concerned merely with making the loan possible and not with equalising interest rates. The extent of the Bank's guarantee will be just enough to make the securities marketable at reasonable terms.

In the case of Bank-guaranteed loans, interest rates will depend upon the willingness of the market to absorb the issue. These loans will be secured by the credit of the borrower and by the credit of the Bank as guarantor. The extent of the Bank's guarantee will vary with the conditions of the market and the position of the borrower. Some loans will be fully guaranteed as to principal and interest, others will be only partially guaranteed.

The guarantee of the Bank will undoubtedly reduce the risk but it cannot completely eliminate risk on a loan. Even on securities fully guaranteed by the Bank, investors will have to consider the credit of the borrower and evaluate the security partly in terms of the borrower's reputation and financial position. On securities guaranteed by the Bank only in part, the reputation and position of the debtor will be even more important in determining the attitude of investors. The effect of the Bank's guarantee, therefore, will be to reduce the difference between rates of interest paid by various foreign borrowers although differentials will not be eliminated.

Borrowers on guaranteed loans will pay the coupon interest rate to investors and will pay a guarantee fee to the Bank. As stated in the answer to Question 7, this fee may be an annual charge, a fixed amount in a single payment, or a combination of fixed fee and annual charge. The annual cost of a loan to the borrower will be the interest plus the guarantee fee. This cost cannot well be less than the interest rate which will be paid by borrowers who do not need the Bank's assistance.

When the Bank participates in a loan, its position will generally be the same as that of the other participating interests. Its part of the issue will have the same coupon rate and the same terms as the rest. The Bank's participation will influence the interest rate only in so far as it makes possible a larger loan than could otherwise be floated under the given conditions. When the Bank guarantees a loan and also participates in it, the Bank will receive its guarantee fee based on the total amount of the issue. The securities which it holds will be the same as the securities sold to the public and will bear the same interest rate.

There may be instances in which the Bank will participate in a loan without guaranteeing the issue. Subsequently, to dispose of its holdings, it may be necessary to guarantee the issue. The bonds would then be on the market in two forms: guaranteed and unguaranteed. The guaranteed bonds taken from the Bank's portfolio could no doubt be sold at a premium under the assumed conditions, and in this way the Bank could be reimbursed for its risk. When the Bank guarantees and sells securities it holds, there need be no change in the interest rate to the borrower, and no additional guarantee fee.

On loans made directly by the Bank, the interest rate will be related to the rates on loans which it guarantees or in which it participates. Since the Bank is to lend only when the borrower cannot secure funds at reasonable rates, there would seem to be two types of loans which it might make directly.

The first type of direct loans would be to borrowers of good credit standing who are not able just then to obtain funds from private investors because of financial stringency in world capital markets during a depression period. Their inability to borrow is purely temporary. The Bank can reasonably expect to dispose of such securities as soon as financial conditions improve. The Bank might charge such borrowers interest rates approximately equal to the rates at which the borrowers could secure funds under fairly normal conditions.

The second type of direct loans would be to borrowers who are not able to obtain funds at reasonable rates because of conditions peculiar to them rather than to the financial market. In this case the Bank's interest rates would have to include its own interest cost plus risk premiums, which would be roughly equivalent to the amounts which it would receive on guaranteed loans. Probably since these risks are greater than those guaranteed by the Bank, the annual cost to the borrower on such direct loans would be somewhat higher than the total annual cost, interest and fee, on guaranteed loans.

The question of the precise interest rate to be charged on any given loan must be left to the discretion of the Directors. Too many factors are involved to specify in advance all of the conditions which might influence rates, since the state of the financial markets and the credit position of the borrowers will vary from time to time. Moreover, loans will be made for different purposes and with different conditions. Each of these factors will require evaluation in each specific case. Investing institutions regularly take such factors into consideration, and the Bank's directors will have to make decisions of the same character. To a degree, the Bank's policy will be determined by the ability of private investors to make loans and the terms which private investors expect.

The Bank's operations are intended to reduce risks to investors, and this reduction of risks will be reflected in a larger volume of lending and lower interest rates than would prevail in the absence of the Bank. The preference of investors will continue to be reflected in differences in interest rates for various foreign securities.

Question 22.

Will it be possible for the Bank to avoid making loans based chiefly on political considerations?

Reply.

The Bank is designed to be an international economic agency to facilitate productive international investment without regard to political considerations. In deciding on loan applications, the Bank is not to be influenced by the political character of the country requesting the credits. This provision is part of the general requirement that the Bank shall scrupulously avoid interference in the political affairs of member countries (IV–19).

The greatest assurance that the operations of the Bank will be based exclusively on economic considerations is given in the provisions of the proposal. The Bank may guarantee, participate in, or make loans only for a specific project or program that has been investigated by a competent committee and has been approved as one that will increase the productivity of the borrowing country and for the servicing of which the prospects are favorable (IV–1 (*c*)). The investigating committee is to consist of experts selected from the technical staff of the Bank and one expert selected by the country applying for the loan. With these requirements, no loan can be made to a country for other than purely economic purposes, and the standards which prospective borrowers must meet are those which protect the economic interests of lender and borrower.

The character of the Bank's operations should give further assurance that political considerations will not affect the decisions of the Bank. The greater part of the Bank's operations will be directed toward encouraging and facilitating international lending by private investors. While the Bank would generally be prepared to guarantee or participate in loans approved by the technical committees, it would exert no pressure on private investors to undertake such loans. It is reasonable to assume that private investment institutions would not give weight to political factors, except as the stability of the government of the borrowing country affects the risk element in all foreign loans. There is thus a further check by private investors on all loans guaranteed or participated in by the Bank.

The international character of the Bank is also a protection against loans made for political purposes as previously discussed in the answer to Question 15. The Bank itself can have no policy outside the purely financial sphere. So far as concerns individual member countries, they do undoubtedly have important international political interests. However, it would be quite difficult for any member country to utilize the Bank for the purpose of furthering its political interests. Each member country is represented on the Board by one member, and no country can cast more than 25 percent of the aggregate votes (V–1). Furthermore, the Board is expected to consult with the Advisory Council on matters of general policy. The Council is to consist of men of outstanding ability, whose primary concern would be with economic and financial rather than with political matters (V–5).

It remains true that the possibility always exists that pressure will be exerted to induce the Bank to extend foreign credits because they are politically necessary. So far as possible, the draft proposal is designed to minimize such influences in international lending. We recognize, however, that no set of rules will of itself completely eliminate political considerations and that proper limitation of the Bank's activities depends ultimately on the character of the men responsible for its operations.

This does not imply that international loans for political purposes have no justification. Obviously, there will be instances when loans may properly be made to aid a friendly government. But such loans should not be made with the aid or encouragement of the Bank, which is exclusively concerned with international investment for productive purposes, nor should such loans be made with funds provided by private investors. Where loans must be made for political purposes, the funds should be provided by the interested government or governments, without requiring either the Bank or private investors to assume the risks inherent in such loans.

13*th April*, 1944.

1. United Kingdom officials have carefully studied the United States Treasury's preliminary draft outline of a proposal for a Bank for Reconstruction and Development, and have had the advantage of discussions on the matter with the technical representatives of India and the Dominions whose general reactions to the problems were very much on the same lines as our own. As a result of this, it is now possible to indicate the following preliminary comments. It is noted that the scheme is a tentative proposal, which has not yet received the official approval either of the United States Treasury or of the United States Government; and, in the same way, the following comments are those of technical experts, which in no way commit the Government of the United Kingdom.

2. The criticisms made are not to be regarded as in any way non-co-operative or obstructive. It is very fully recognised that loans from creditor countries to debtor countries in the early post-war period are essential to avoid widespread economic chaos and much needless human suffering; that without them no international monetary plan can have a fair start; and that the reduction of barriers to trade will be frustrated by acute difficulties in balancing international payments. United Kingdom officials are, therefore, highly appreciative (and this view was strongly shared by all the Dominion experts) of the initiative which the United States Treasury have taken and of the generosity of approach which obviously underlies many of the provisions of the scheme, so far as concerns the part to be played by the United States.

3. Nevertheless, there are two fundamental matters, about which it seems vital that agreement should be reached before proceeding into all the consequential details. It is thought, therefore, that much the best way to make satisfactory progress will be to begin with a discussion of certain fundamental considerations, without in the early stages commenting in detail upon all the provisions of the plan tentatively put forward by the United States Treasury. Until this stage has been reached it is felt that not much useful purpose would be served by attempting to discuss in detail all the provisions of the plan tentatively put forward by the United States Treasury. This does not mean that many of these details could not be worked into a final draft, embodying the general principles which the United Kingdom officials favour. But at this stage it seems more profitable to get clear on certain fundamentals than to spend time on the precise technique by which, after they are agreed, they will have to be worked out in practice.

4. Primary importance is attached by the United Kingdom officials to two fundamental conditions :—

(i) In the United States Treasury outline for the Reconstruction Bank (references are to the text of the 24th November, 1943) IV 7 provides that "the Bank shall impose no condition upon a loan as to the particular member country in which the proceeds of the loan must be spent." United Kingdom officials agree in thinking that the principle lying behind this should be fundamental in its application to any loans sponsored by an international institution. No doubt, in the future as in the past, there will be room for valuable and important loans, where the provision of the finance and the employment of it in the purchase of goods are closely tied together. (The United Kingdom Export Credits Guarantee Department and the United States Export-Import Bank are examples. Other similar applications are likely to be appropriate from time to time.) But, wherever the link between the source of the finance and the place of the expenditure is appropriate, the loan in question should be financed domestically by the country directly concerned. On the other hand, the proceeds of any loan raised or guaranteed or sponsored by an international institution should be, without qualification, free exchange available to the borrower to expend in any market at his choice for any requirements arising out of the project to be financed.

The difficulty felt by United Kingdom officials is, however, that, whilst the above principle is accepted in the constitution of the proposed bank, the provisions in detail appear in fact to have the result of tying the source of finance to the place of its expenditure with particular strictness. The provision that, subject to certain exceptions, it is the country in which the loan is expended which has to find the money seems to undo the practical effect of the principle which has been put forward in the clause of the constitution quoted above. It is appreciated that the reason which lies behind this is the anxiety to bring all countries in on a symmetrical basis. It is extremely difficult, indeed impossible, for a country, which has no investible surplus, to contribute funds for actual investment unless it be on the tied principle. The United States Treasury Plan, therefore, tries to temper the wind to the position of those countries which are not likely to have an investible surplus. Nevertheless, United Kingdom officials feel it to be essential that some other way must be found round this particular difficulty. They are, therefore, led on to a second fundamental principle, closely associated with that just enunciated, namely, as follows:—

(ii) No country should be obligated to subscribe, directly or indirectly, to the loans sponsored or guaranteed by the international bank, unless its monetary authority has approved such subscription as being within the capacity of a country's balance of payments at the time when it has to be made. Without this provision the maintenance of monetary equilibrium, which is one of the main purposes of the monetary and investment schemes taken as a whole, would be gravely endangered, and the schemes might indeed prove self-defeating. It is suggested, therefore, that the actual subscription by the government or in the market of the lending country of each individual loan approved by the international bank must be subject to the prior approval of the monetary authority, which approval must be given in the light of the first condition, that the proceeds of the loan, once subscribed, should be free exchange available to the borrower for expenditure in any market.

5. These conditions still leave the international institution free to provide a vital function, in the provision of which all member countries would be expected to come in on the same footing relatively to their resources.

6. For whilst the actual provision of funds can obviously only be supplied by those countries in which the monetary authority sees its way to an investible surplus, there is no reason why the risks of the resulting transaction should also be concentrated, as has been the case hitherto, in the absence of an international institution, on the country which is in a position to find the money. It is accordingly suggested that the following should be the fundamental functions of the new institution.

7. The facilitation of suitable loans from creditor countries to countries in need of reconstruction and development is so much in the general interests of world economy and of equilibrium in the international balances of payment that countries which fall into neither of these two categories, as well as those which do, can reasonably be asked to contribute by accepting a contingent liability under guarantees within the limits of their reasonable capacity. This is, indeed, a function of the bank which the draft already contemplates. This is felt to be the promising line of development. Here there is real scope for joint international action on an equal footing, whereas, in the matter of the actual provision of funds, it is quite clear that joint and equal participation is, from the nature of the underlying facts, out of the question. This leads to the conception that only quite a small part of the Bank's capital would be called up to start with, and that for the rest loans sponsored by the Bank would be guaranteed as an international obligation to which all the countries concerned would subscribe. Such loans could be offered in the first instance in the market on precisely the lines contemplated in the draft. Failing this and if the loan, even with the guarantee could not be raised on the market at an appropriately low rate of interest, then it might be that the government of the country, by which the loan is to be made, should itself make the loan and obtain the benefit of the guarantee.

8. This seems an appropriate division of functions, which will appeal to the world as just and right. Only those countries with an investible surplus can put up the money; but that is no reason why they should also run all the financial risks, perhaps quite substantial, of reconstructing the devastation of war and developing the more backward countries. The great increase of trade arising from the granting of the loans would benefit all alike, and it is just and right that the resulting risk should be shared all round. This should be within the capacity, divided, of course, in appropriate proportions, of all participating countries. It embodies both the justice and the common-sense of the underlying situation.

9. In view of the need to ensure that no country should be suddenly called upon under its guarantee to subscribe more than should be within the capacity of its balance of payments, it is important to provide, so far as possible, that any calls on the guarantees shall be spread over as long a period as possible. For this reason it is suggested that the service of the loans should take the form of terminable annuities, covering both interest and repayment of principal, so that, in the event of default, no large capital sum falls due for repayment, but only the continuance of the annuities.

10. A further suggestion, to which importance is attached, is that the institution should charge a substantial commission at a flat rate of (say) 1 per cent. per annum on all loans guaranteed by it. For example, if the standard rate of interest at which it seemed proper for the bank to issue a loan at a given date were (say) 3 per cent. and the cumulative sinking fund were taken at 1 per cent. (though a higher rate of sinking fund would be appropriate for projects requiring more rapid repayment), then the total cost to the borrowing country, including commission, would be at the rate of 5 per cent. per annum, to cover both interest and capital. This would, in all the circumstances, be far from burdensome. If there were particular cases where it seemed right that help should be given on quite special terms, then some other appropriate source would have to be found for that part of the annual charge of which it was desired to relieve the borrowing country. The commissions thus collected would not be divided between the participants in the bank, except in the event of liquidation. But both the accumulations and the current commissions would be available to the institution to meet any defaults before calling on guarantees, and it should be provided that they would be so used.

11. There is a second function to be performed by the bank, to which high importance is attached. The provision of cash to implement a loan, though a very essential part of the proceedings, is only one side of the picture. The right selection of projects is scarcely less important to permanent success. The expert examination of projects for international loans, for which a guarantee by the United Nations bank has been or may appropriately be sought, should, therefore, be a primary function of the institution. This expert examination should have particular regard to the degree of priority which should be accorded to each of such projects, to the reliability and technical capacity of those who would handle the spending of the loan, and to the prospects of the recipient country being in a position to service it in free exchange. Here, again, there is a function of special suitability for an international institution.

12. Finally, it should be made clear, what is, no doubt, in fact the intention, that the institution would be concerned with loans for post-war reconstruction as well as for new development. For it is only in this event that it will serve to bridge the gap which now exists between the purposes of UNRRA and the purposes of the International Monetary Fund.

13. United Kingdom officials would welcome an opportunity of discussing with the United States Treasury the principles here outlined, in the hope that agreement could thus be reached, which would serve as a basis for wider discussion between the experts of the United Nations as a whole. United Kingdom officials are very conscious of the great importance of this question and of the service rendered by the United States Treasury to the United Nations as a whole by having put forward concrete suggestions on the matter with a view to bringing the matter to a head and to a conclusion.

April 1944.

A STATEMENT ON THE ESTABLISHMENT OF A BANK FOR RECONSTRUCTION AND DEVELOPMENT.

The technical experts of some of the United and Associated Nations who have participated in the discussions on international financial problems are of the opinion that the revival of international investment after the war is essential to the expansion of trade and the maintenance of a high level of business activity throughout the world. In their opinion, the most practical method of encouraging and aiding private investors to provide an adequate volume of capital for productive purposes is through the establishment of a permanent Bank for Reconstruction and Development. They have set forth below the principles which they, as technical experts, believe should be the basis for this Bank. Governments are not asked to give final approval to these principles until they have been embodied in the form of definite proposals.

I.—*Purposes and Policies of the Bank.*

1. The Bank will assist in the reconstruction and development of member countries by facilitating provision of long-term investment capital for productive purposes through private financial agencies. It will do so by guaranteeing and participating in the loans made by private investors.

2. The Bank will supplement private financial agencies by providing capital for productive purposes out of its own resources, on conditions that amply safeguard its funds, when private capital is not available on reasonable terms.

3. The Bank will promote the long-range balanced growth of international trade by encouraging international investment for the development of the productive resources of member countries.

4. The Bank will take into consideration, in its operations, the effect of international investment on business conditions in member countries. In the immediate post-war years, its policy will be to assist in bringing about a smooth transition from a wartime to a peacetime economy.

II.—*Capital of the Bank.*

1. The capital of the Bank will be the equivalent of $10 billion, to be subscribed by member governments. Liability on shares will be limited to the unpaid portion of the subscription.

2. A substantial part of the subscribed capital of the Bank will be reserved in the form of unpaid subscriptions as a surety fund for the securities guaranteed or issued by the Bank.

3. The initial payment on shares will be 20 per cent. of the subscription, some portion of which should be in gold and the remainder in local currency. Further payment on subscriptions will be made as the Board of Directors may determine, but not more than 20 per cent. of the subscription may be called in any one year.

III.—*Operations of the Bank.*

1. The Bank will deal through the governments of member countries and their fiscal agencies, the International Monetary Fund, and other international agencies owned predominantly by member governments.

It may also deal with the public and private institutions of member countries in the Bank's own securities or the securities which it has guaranteed.

2. The Bank will not finance the local currency needs of a borrower except in those special circumstances where facilities are not available for borrowing investment funds at home.

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3. The Bank may guarantee, participate in, or make loans to any member country, its political subdivisions, and business and industrial enterprises in a member country, under the following conditions:

(a) The national government, central bank or a comparable agency guarantees the payment of interest and principal.
(b) The borrower is otherwise unable to secure the funds from other sources under conditions which in the opinion of the Bank are reasonable.
(c) A competent committee, after careful study of the merits of the project, reports that the loan would serve to raise the productivity of the borrowing country and that the prospects are favorable to the servicing of the loan.
(d) Loans are made at reasonable rates of interest with schedules of repayment appropriate to the project and the balance of payments prospects of the borrowing country.
(e) The Bank is compensated for its risk in guaranteeing loans made by private investors.

4. To encourage international investment in equity securities, the Bank may obtain a governmental guarantee of conversion into foreign exchange of the current earnings on such investments. It may also employ a small portion of its capital directly in equity investment.

5. The Bank will impose no conditions as to the particular member country in which a loan will be spent. The Bank will make arrangements to assure the use of the loan only for the approved purposes.

6. In providing the funds for loans made by the Bank, its policy will be:

(a) To furnish the currencies needed by the borrower in connection with the loan.
(b) To make available an appropriate part of the loan in gold or needed foreign exchange when a developmental program gives rise to an increased need for foreign exchange.
(c) To furnish gold or needed foreign exchange for a part of the loan expended by the borrower at the request of countries in which portions of the loans are spent.

7. No loans may be guaranteed or made by the Bank without the approval of the country in whose currency the loan is made.

8. With the approval of the representatives of the governments of the member countries involved, the Bank may engage in the following operations:

(a) It may issue, buy, or sell its own securities, securities taken from its portfolio, or securities which it has guaranteed.
(b) It may borrow from member governments, central banks, or private financial institutions in member countries.
(c) It may buy or sell foreign exchange where such transactions are necessary in connection with its operations.

IV.—*Repayment Provisions.*

1. Payment of interest and principal on loans participated in or made by the Bank will be in currencies acceptable to the Bank or in gold. Interest will be payable only on amounts withdrawn.

2. In the event of an acute exchange stringency the Bank may, for brief periods, accept local currency in payment of interest and principal under conditions that safeguard the value of the Bank's holdings.

3. Payment of interest and principal, whether made in currencies or in gold, must be equivalent to the gold value of the loan and of the contractual interest thereon.

V.—*Management.*

1. The administration of the Bank will be vested in a governing board and an executive committee representing the members. The governing board may appoint an advisory council consisting of representatives of banking, business, labor and agricultural interests, and such committees as it finds necessary.

2. The distribution of voting power will be closely related to the share holdings of the member countries.

3. All decisions will be by simple majority of the votes cast except where otherwise specified.

4. The Bank will publish regularly a balance-sheet showing its financial position and a statement of earnings showing the results of its operations. The Bank may also publish from time to time such other information as would be helpful to the sound development of international investment.

5. One-fourth of the profits would be applied to surplus until surplus equals 20 per cent. of the capital. The remaining profits would be distributed in proportion to shares held.

VI.—*Withdrawal and Suspension.*

1. A member country may withdraw from the Bank by giving notice in writing.

2. A member country failing to meet its financial obligations to the Bank may be declared in default and may be suspended from membership, provided that a majority of the member countries so decides.

3. If a member country elects to withdraw or is dropped from the Bank, its shares of stock would, if the Bank has a surplus, be repurchased at the price paid. If the Bank's books show a loss, the country would bear a proportionate share of the loss. Appropriate provision should be made for meeting the contingent liabilities.

May 1944.

UNITED STATES REPLY TO THE UNITED KINGDOM NOTE ON THE BANK FOR RECONSTRUCTION AND DEVELOPMENT.

MEMORANDUM.

1. Members of the technical staffs of the United States Treasury and other Departments of the Government have given careful consideration to the memorandum of the United Kingdom technical experts on the tentative proposal for a Bank for Reconstruction and Development.

We appreciate the suggestions in the United Kingdom memorandum. We believe that on most underlying principles there is complete agreement between us and the United Kingdom technical representatives. On some matters of principle, we believe that this supplementary memorandum will clarify the position of the American technical men. There will then remain a few important differences which can be cleared in the contemplated direct discussions.

2. Obviously, we are in full agreement with the United Kingdom technical representatives on the importance of adequate international investment in avoiding pressure on the balance of international payments and in encouraging the expansion of world trade. The proposed Bank is intended to facilitate the provision of capital for reconstruction in the immediate post-war period as well as for development purposes. The Bank should be in a position to perform the functions that lie outside the scope of UNRRA and the International Monetary Fund.

3. A brief statement of our approach to the problem of international investment will facilitate more detailed discussions of the tentative proposal of the 24th November, 1943, and the preliminary draft of the statement of principles of April 1944.

We regard international investment as an international problem that can best be met by the co-operation of all countries in a Bank for Reconstruction and Development. Such a Bank should primarily be concerned with aiding and encouraging the provision of private funds for international investment by means of guarantees. The greater part of the Bank's capital should not be called up for use by the Bank in making loans, but should be set aside in the form of uncalled subscriptions as a reserve for meeting the Bank's obligations on guaranteed loans.

There will, nevertheless, be occasions when the Bank may find it necessary to provide funds in whole or in part from its own resources. When the Bank approves of a loan which private investors are not, for one reason or another, prepared to take up, the Bank must be in a position to make the loan out of its own resources (whether paid-in capital or borrowed funds). Whatever merit there may be in the concept of anonymous lending would seem to be applicable to loans of the Bank no less than to operations of the International Monetary Fund. The Bank must avoid involvement in the political implications which are so important in direct loans from one government to another. Our views on such loans are given in the Questions and Answers on the Bank for Reconstruction and Development (question 15).

For these reasons, the tentative proposal has made provision for direct loans by the Bank. It is hoped that it will be possible for the Bank to encourage an adequate flow of capital in international investment through its guarantee of loans (III–4) and its influence toward obtaining governmental guarantee of the transfer of earnings on equity investments (III–5). If this should be so, the Bank could avoid use of any considerable amount of its own resources in direct loans or in equity investment. This is, of course, a matter which can be determined only by actual experience. But even if considerable use of the Bank's resources should be necessary after the war, it is hoped the funds can be raised by the Bank to a considerable extent by the sale of its own securities.

4. Once it is admitted that the Bank must hold resources for use in making loans or in acquiring equity securities, it is essential that all member countries should subscribe to the Bank and pay in an equal portion of their subscriptions.

Whatever differences there are in the international economic position of member countries must be taken into account by the Bank in its actual operations.

We recognize that some countries do not have an investable surplus, and that they may not be in a position to allow the free use of their national currencies in acquiring other currencies. The fullest provision is made for protecting the interests of such countries. Provision III–8 of the draft statement of principles states that no loans may be guaranteed or made by the Bank without the approval of the country in whose currency the loan is made; and provision IV–9–(*c*) states that the Bank may buy or sell foreign exchange only with the approval of the member countries involved. It should be clear that a country which does not have an investable surplus, or whose currency is subject to restrictions on the export of capital, is fully protected from a deterioration in its balance of payments through the operations of the Bank.

In this connection, it should be noted that the draft proposal makes some provision for avoiding pressure on the balance of payments of the borrowing country or of the country selling the capital equipment. Provision III–7–(*b*) states that it will be the policy of the Bank to make available part of the loan in gold or needed foreign exchange when a developmental programme gives rise to an increased need for foreign exchange by a borrowing country. And provision III–7–(*c*) states that it will be the policy of the Bank to furnish gold or needed foreign exchange for a part of the loan expended by the borrower at the request of countries in which portions of the loans are spent.

5. We cannot agree that the tentative proposal, either in principle or in detail, involves any restrictions on the free use of loans guaranteed or made by the Bank. The preliminary draft of the statement of principles provides (III–6) that the Bank will impose no conditions as to the particular member country in which a loan will be spent. This principle is in every respect unmodified so far as the actions of the Bank are concerned.

When the Bank has given its approval to a loan, it must in the first instance be offered to the market, if necessary with the Bank's guarantee. The proceeds of a guaranteed loan may be spent by the borrower in any member country. The Bank's sole concern is to make arrangements to assure the use of the loan for the approved purposes.

The preliminary draft of the statement of principles requires (III–7–(*a*)) that, in providing the funds for loans made by the Bank, its policy will be to furnish the currencies needed by the borrower in connection with the loan. In the normal course of events, the Bank would make inquiry of the country where the funds are to be spent (say, the United Kingdom) whether it has any objection to the loan (III–8). The Bank could then be informed that the United Kingdom's foreign exchange position might be impaired by such a loan. Under the circumstances, the loan would not be made in sterling. If other currencies (say, some dollars) are needed by the borrower to make its purchases in the United Kingdom, the Bank would attempt to furnish the currencies needed. The Bank would then seek the approval of the United States to make all or part of the loan in dollars (III–8) or to purchase sterling necessary for the loan (III–9–(*c*)).

Whether the United States would give its approval to the loan on the exchange transaction is a matter within its discretion. The Government might well take the position that it is prepared to approve the loan, even though the dollars are to be used to acquire sterling, particularly if the Bank's dollar resources have been derived from the sale of its own securities in the United States. On the other hand, the Government might take the position that it cannot approve the use of public money (that is, the paid-in subscription) for this purpose.

6. We submit that in practice the arrangements we propose do not differ significantly from the arrangements the United Kingdom experts propose. Assume that when the market will not take up a guaranteed loan, the Bank must find a member government prepared to make the loan without restriction on the basis of the Bank's guarantee. If the loan is to be spent in the United Kingdom, the Bank would in the first instance probably apply to the United Kingdom Government to make the loan. The Bank would be informed that for various reasons the United Kingdom Government cannot provide the funds. The Bank, presumably, would then apply to the United States Government or to other governments in search of a lender; and the United States Government would take whatever position seemed suitable to its interests.

The practical effect is much the same whether the Bank holds resources which it can use for such loans, or whether the Bank applies to a government to make the loan with the Bank's guarantee. On the whole the chances of getting approval for such a loan would seem to be better where the Bank (rather than the Government) makes the loan, where the resources have already been contributed by the Government (and must not be provided at the time of the request), and especially where the funds have been secured by the sale of the Bank's obligations to private investors.

7. With most of the other points raised in the memorandum of the United Kingdom experts we are in substantial agreement.

(*a*) We agree that only a small part of the Bank's capital should be paid in at the beginning. How much should be paid in can be determined only in the light of experience. If the Bank finds that securities it guarantees are easily marketed, it may be possible to avoid any considerable volume of direct lending by the Bank. Furthermore, if the Bank's own securities can be sold in the market at reasonable rates of interest, it may be possible for the Bank to raise funds for its direct lending operations without calling for a substantial payment of capital.

The draft proposal now provides for an initial payment of 20 per cent. of the subscribed capital, and if this should prove excessive, the Bank could return uniform proportions of the subscription. We shall be glad to discuss this provision and to consider any suggestion to reduce the initial payment to less than 20 per cent. of the subscription.

(*b*) We agree that no country can be obligated to be a lender on international account, whether directly by the sale of Bank guaranteed securities to its nationals or indirectly by the use of its capital subscription to the Bank in making loans, unless its monetary authorities give their approval. This is already provided by III–8 of the statement of principles: "No loans may be guaranteed or made by the Bank without the approval of the country in whose currency the loan is made."

We presume it is clear, nevertheless, that a country does not relieve itself of participation as a guarantor on loans made through the Bank, either by refusing to approve the floating of the loan in its capital markets or by expressing its general disapproval of the guarantee of the loan by the Bank. So long as a country is a shareholder of the Bank it is a *pro rata* guarantor, to the limit of its unpaid subscription, on all securities guaranteed or issued by the Bank. When a country withdraws as a shareholder, it does not divest itself of its contingent liability on securities guaranteed or issued by the Bank during its membership; but a country assumes no liability of any kind on securities guaranteed or issued by the Bank while it is not a member.

It appears to us that these points are clear enough, but we restate them to make certain there is no difference of opinion on them.

(*c*) The United Kingdom experts propose a small and uniform guarantee fee on the order of 1 per cent. per annum. We agree that there should be a relatively small guarantee fee; but we doubt the feasibility of a uniform fee.

As explained in the Questions and Answers (question 21), the extent of the Bank's guarantee must be no more than sufficient to enable the placing of the securities with private investors at reasonable interest rates. In some instances the Bank will guarantee principal and interest in full; in other instances, only a partial guarantee will be needed. We are of the opinion that the guarantee fee will have to be commensurate with the risk assumed by the Bank, including the extent of the guarantee. Therefore, the fee should be collected on the basis of outstanding principal (rather than on the original capital amount) and should take some account of the differences between borrowers.

We recognise that market evaluations often exaggerate the premium for risk and that the Bank, through its guarantee, will be able to reduce the differences in interest rates paid by various foreign borrowers, although differentials will not be entirely eliminated. While a uniform guarantee fee does not seem feasible, the fee itself should be relatively small and differences in the fee (making allowance for the extent of the guarantee) can be kept to a minimum.

The magnitude and uniformity of guarantee fees are, of course, matters of policy that should be decided by the governing board of the Bank. To include such details in a statement of principles might impose on the Bank a rigidity of policy that might hamper its effective operation.

(*d*) It is suggested by the United Kingdom experts that payments on loans guaranteed by the Bank take the form of terminable annuities. This precise method of repayment is not in sufficiently wide use in the American capital markets to justify the issuing of securities in this form. No doubt the Bank itself and institutional investors would have no objection to this method of repayment. It is probable that individual investors would prefer a security in which the capital amount is repaid at maturity.

In practice, the effect of terminable annuities can be achieved by use of serial bonds. The amount falling due annually can then be adjusted with greater flexibility on the basis of the need of the borrower and the preference of the market. Quite conceivably, the interest cost on such bonds might be less in the aggregate than with terminable annuities, because of the greater ease of suiting the maturity preferences of investors. From the point of view of the borrower, serial maturities provide the same ease and regularity in repayment as terminable annuities.

On this matter, too, it would be preferable to leave the determination of policy to the governing board of the Bank. The most suitable form of the repayment of loans will depend not only on the project, but also on the customary practices of the lender and the borrower. The governing board of the Bank should not be restricted on such matters of detail.

(*e*) We are in full accord with the suggestion of the United Kingdom experts that the guarantee fees should be retained by the Bank as a reserve to meet contingent liabilities. We are also of the opinion that a part of the receipts on direct loans of the Bank should be regarded as a premium for risk and should be reserved for meeting losses.

(*f*) In meeting obligations of the Bank arising from defaults or from temporary suspension of transfers under IV–2, the Bank should first use the accumulated reserve of guarantee fees and current receipts of guarantee fees. If this reserve should prove inadequate, the Bank would then utilise the capital subscription of member countries (either already paid in or called for the purpose), drawing upon all countries *pro rata*. Member countries would be obligated to permit the conversion of this *pro rata* call into the currencies needed to meet the obligations of the Bank (III–2).

8. We note with satisfaction the general approval of the tentative proposal and the view that a final draft might appropriately include many of its provisions. We are prepared to discuss with the technical representatives of the United Kingdom the statement of principles recently submitted to the United Kingdom Treasury and the memorandum that has in turn been submitted to the United States Treasury. We share with the United Kingdom technical representatives the feeling that further discussions with them would facilitate general agreement among the experts of the United Nations on the principles for a Bank for Reconstruction and Development.

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CONFIDENTIAL
I.M.C.(44)(GENERAL)5th Meeting
22nd June, 1944

COPY NO. 2)

BANK FOR RECONSTRUCTION AND DEVELOPMENT

NOTE of the Fifth Meeting held at 11 a.m. on Thursday, 22nd June, 1944 on board ship.

PRESENT:

As at previous meetings.

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1. The meeting had before it the U.S. preliminary draft outline dated November 1943 (printed in I.M.C.(44)(B)1), a memorandum by Lord Keynes suggesting modifications of this U.S. Treasury draft (I.M.C.(44)(B)2), a note by Dr. Baranski (I.M.C.(44)(B)3) and a note by Lord Keynes about stabilization loans (I.M.C.(44)(B)4).

Outline of Lord Keynes' Proposals

2. Lord Keynes gave a brief outline of the reasons which had led him to suggest the modifications, contained in I.M.C.(44)(B)2, of the U.S. Treasury draft. In the original U.S. draft before November 1943, the main function of the Bank had been to make loans out of its own capital. Lord Keynes had urged on Dr. White the importance also of the guarantee functions of such an institution; only countries with favourable balances of payments would be in a position to undertake foreign investment, but these investments would benefit not only lenders and borrowers but many other countries also. The first change proposed by Lord Keynes was therefore that there should be a separation of the function of exporting capital from the function of guaranteeing loans. The November 1943 draft and the "Questions and Answers" went a long way to meet this point, but the result was not very clear. The modifications now suggested by Lord Keynes were intended by him to clarify what he understood to be implicit in the November 1943 draft. For direct loans, he accepted the U.S. proposals. In a separate watertight compartment should be the guarantee fund which, in his view, should absorb 80 per cent of the subscribed capital of the Bank.

3. Another major change introduced in Lord Keynes' draft was the suggestion that loans and guarantees made by the Bank, though on a prudent scale, should not be conducted according to strict commercial criteria. Many investments, e.g. by the U.K. and the Netherlands in Far Eastern rubber, would have proved of immense benefit to mankind even if they had not been commercially successful.

4. A third modification introduced by Lord Keynes related to the treatment of borrowers who got into difficulties. He wanted to find a solution of this problem which would minimise the prospect of countries being forced into defaulting upon obligations to an international institution. The revised U.S. draft went some way to meet this point, but the Bank was only left

with one method of lessening the burden upon debtors in times of crises. He thought therefore that the provisions for relaxation of service charges ought to be extended, and that some provision should be made for stabilization loans.

General Views on Lord Keynes' proposals

5. In the course of a general discussion upon I.M.C.(44)(B)2, the following points were made:-

(i) Dr. Grosfeld and Dr. Feierabend stressed the need for the Bank to start operations as soon as possible after the cessation of hostilities, so that it would be in a position to assist, within say three months, countries at present occupied by the enemy. Lord Keynes thought that at this early date there might be serious limitations upon the amount of capital goods that could be made available, and that the functions of the Bank would therefore have to be confined at first to the making of stabilization loans.

(ii) Dr. Baranski and Dr. Kirkor thought that it would be necessary to work out plans for the utilization not merely of foreign but also of domestic capital, because the amount of domestic investment affected the need for, and the ability to pay service charges on overseas loans. Baron Boel and Dr. Varvaressos, on the other hand, saw difficulties in this proposal because of the interference in domestic issues which might result.

(iii) Mr. Beyen pointed out that an international institution would probably accept losses less philosophically than would private investors; he thought therefore that it would be desirable for the Bank to build up a strong reserve as quickly as possible. He also suggested that it should be made clear in the draft that the Bank would be able to make medium-term loans (of 5 to 10 years' duration) as well as long-term loans.

(iv) All the Delegates expressed the view that Lord Keynes' proposals represented a real improvement upon the November 1943 draft and that they happily harmonised the legitimate interests of investors and borrowers with those of the rest of the world.

Detailed consideration of U.S. November 1943 Draft as modified by Lord Keynes' proposals.

Preamble

6. Mr. Beyen suggested that it might be desirable to transfer to the Preamble the new section III(6) of Lord Keynes about the acceptance of risks by the Bank. After some discussion, in the course of which Sir Wilfrid Eady emphasized the desirability of giving unquestionable authority to the Managers of the Bank to take risks, Lord Keynes suggested that reference to the point should be included both in the Preamble and in the main body of the text.

I. The purposes of the Bank.

7. No comments were made on this section.

II. Capital Structure of the Bank

8. Lord Keynes gave some arithmetical illustrations of the way in which his suggestions would work out. It had been understood that the United States would probably be willing to subscribe 33 per cent, and the U.K. 10 per cent of the capital of the Bank. The remaining 57 per cent would be subscribed by at least 30 countries whose individual subscriptions would thus vary from 1 per cent up to about 4 per cent. If the standard rate of interest were to be 3½ per cent, the standard amortisation 2 per cent, and the standard commission 1 per cent, the commission would equal nearly one-fifth of the total service of the loans. Therefore 20 per cent of the Bank's loans could be in default at any one time before it would be necessary to call upon the guarantors. Assuming the acceptance of the 20%/80% division of the capital, the guarantee fund would amount to £2 billions. Service charges on this sum at 5½ per cent would be £m110, and the cost of implementing the guarantees - on the worst possible assumption that all loans went into default right from the start - would be £m110 per annum, of which the U.K. would be liable to find £m11. On any reasonable hypothesis as to the frequency of default, the burden upon the U.K. would be smaller and that upon other countries would be correspondingly less.

9. Mr. Beyen raised the question whether Lord Keynes' draft effectively accomplished his stated intention of dividing the capital available for direct loans and for guarantees into watertight compartments. He thought that the new clause IV(8) (on page 7 of I.M.C.(44)(B)2) did not make it clear whether guarantees were to be secured in part on paid up capital or not. His view was that the guarantee should be secured on the paid up capital as well as upon the uncalled capital. Lord Keynes thought otherwise, and after some discussion it was agreed, for purposes of clarification, to insert "only" after "secured" in the new IV(8).

10. Dr. Kuo tentatively suggested that it might be desirable to increase above 20 per cent the proportion of the subscribed capital of the Bank which would be available for direct loans by the Bank. Dr. Mladek also pointed out that, in the early post-war years when there would be severe shortages of capital goods available for export, it might not even be possible for the Bank to make direct loans to the extent of 20 per cent of the capital. Lord Keynes thought, however, that the guarantee of the Bank would prove attractive to U.S. investors, who would necessarily be the largest subscribers to loans in this early period and that later on, it would prove advantageous to everybody for the larger part of the capital of the Bank to be taken up in guarantees rather than direct loans.

11. The other changes proposed by Lord Keynes in II were thought to be acceptable.

III. General Provisions for Loans to Member Countries

12. Sir Wilfrid Eady drew attention to IV(1)(b) and IV(6) of the November 1943 draft which attempted to ensure that recourse should not be had to the Bank in cases where loans could be secured on reasonable terms through private channels. Lord Keynes thought that it would be very difficult to establish satisfactory criteria on this point. Would it, for example, be permissible for the Bank to make or guarantee a loan to a member at 4½ per cent if that member could obtain money outside the

Bank at 5 per cent. It was generally agreed that this section needed redrafting, particularly in view of the impossibility of ever bringing satisfactory negative proof. Lord Keynes mentioned, however, that Dr. White attached considerable political importance to this point, and did not therefore put forward any concrete proposals at the moment.

13. Some discussion took place on the new III(4)(e) which should be read in connection with IV(1)(d) and IV(7) in the November 1943 draft. Baron Boel thought that the words "without unduly encroaching on its discretion" in the new III(9)(e) were somewhat obscure and perhaps by implication derogated from the general principle that there should be non-interference by the Bank with the domestic affairs of particular countries. The question was raised whether complete discretion should be left to a borrower to spend the proceeds of Bank loans how he chose, or whether the Bank should retain powers to enable it to exercise some supervision as to how and where the money was spent. Baron Boel's suggestion, which met with general agreement, was that the draft should be amended to make clear, first that the borrower had discretion to make such arrangements as it deemed most satisfactory, and secondly, that the Bank had a right to intervene only in cases where the facilities of the Bank were gravely abused.

14. Considerable discussion took place on III(4)(d) (formerly IV(8)(d) in the November 1943 draft). Lord Keynes explained that this clause had been inserted to deal with cases in which a large part of the cost of an undertaking would necessarily be incurred for the maintenance of labour as distinct from the import of capital goods. Thus, if it were proposed to undertake large development works in the Yangtse Valley, a comparatively small part of the cost of the undertaking would be incurred in connection with the import of capital goods and most of the money would be required for the maintenance of the labour force employed. Dr. Kirkor pointed out that, even in such a case, the result might be to bring about an increase in imports of consumption goods. The same result would indeed follow from large scale domestic investment. He asked how such secondary increases in imports would be financed. Lord Keynes admitted that there was no provision in the Plan for financing such imports and that this constituted a real gap in the proposals. He was, however, of the opinion that it would be unwise to formulate at the present stage suggestions for filling the gap, because such action might serve to raise the question of the service of loans that have been floated in the past, and because provisions to deal with the problem would serve to make the size of loans somewhat indeterminate. The general view of the meeting was with Lord Keynes.

15. The new clause relating to stabilization loans (I.M.C.(44)(B)4) was accepted by the meeting as highly desirable, but it was agreed that in the seventh line of the draft "consultation" should be deleted and "agreement" substituted.

16. The section now numbered III(5) (formerly IV(9)) was criticized by Mr. Beyen and Dr. Varvaressos as unnecessary in such a statement and it was agreed to raise this point with Dr. White.

22nd June, 1944