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AN INFORMAL MEMORANDUM ON THE SECURITY BEHIND THE OBLIGATIONS OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Prepared in the Office of the
United States Executive Director

A number of people interested in the International Bank have been curious as to why the Bank must raise funds in the United States if the total amount of loans and guarantees the Bank may make cannot exceed the unimpaired subscribed capital, surplus, and reserves of the Bank. Another, and perhaps more pertinent question, from the point of view of the potential purchasers of the Bank's securities, relates to the qualitative and quantitative security behind the obligations of the Bank. Why should the securities of an organization so largely supported by foreign capital and established for the purpose of lending abroad, be regarded as securities of high quality and suitable for fiduciary investors? These are reasonable questions and every investor should satisfy himself as to the validity of the answers. Satisfactory answers will also be required by State authorities who are concerned with the protection of the depositors and policyholders in the institutions which might be expected to purchase the obligations of the Bank.

Consideration was given at Bretton Woods to the concept of establishing an international lending organization which would operate with funds advanced by the member governments. This was discarded because it was believed that foreign lending should not exclude private citizens from participation. It was also recognized that initially most of the obligations issued or guaranteed by the International Bank will be floated in the capital markets of the United States. The risk, however, in case of defaults by countries borrowing from the Bank, was to fall proportionately upon the governments of all the subscribing countries.

In setting up a Bank to operate in this way, it was also recognized as essential that the securities that it would issue should be of high quality and fully suitable for investment by institutions and trustees in the United States. The Articles of Agreement were therefore drawn in such a manner that the resources of the Bank—consisting of its outstanding loans, plus the securities in its reserve funds, plus the amounts due from member governments on their capital subscriptions—would be quite certain, at all times, to be more than sufficient to cover the Bank's obligations. One outstanding resource of the Bank will be the capital subscription of the United States Government, amounting to 3,175 million dollars. The Bank's other resources will also contribute very important backing for its obligations, as the following discussion will show.

Perhaps the best way to analyze the security behind the Bank's obligations is to set forth, in an over-simplified manner, a pro forma statement of the Bank's prospective position some years hence:

Assets	(Billions of dollars)	Liabilities and Capital Accounts	
Cash and short-term securities	1.1	Debentures and obligations on any guaranteed loans	8.0
U. S. Dollars 0.4		Special Reserve	0.5
Other currencies 0.7		Capital	8.0
Loans (including any guaranteed loans)	8.5	Paid-in 1.6	
Special Reserve Fund (Prime securities)	0.5	Uncalled 6.4	
Uncalled subscribed capital (80%)	6.4		
U. S. 2.54			
Other 3.86			
	16.5		16.5

The first assumption that has been made in constructing the foregoing statement is that the Bank has lent to its permissible limit (i.e., to the total of its unimpaired subscribed capital and reserves). The second assumption is that no defaults on loans have occurred. This is reasonable during the period in which funds are still being disbursed. A third assumption is that the special reserve, which accumulates by a charge of 1 to 1-1/2 per cent annually on outstanding loans and which

must be held in liquid form, has been built up to 500 million dollars and has been invested in prime securities (for example, Treasury obligations of intermediate and long term). Finally, it is anticipated that the Bank will have made some loans by the use of currencies paid in as capital; but only a very small provision has been made for such use of currencies other than U. S. and Canadian dollars.

After the Bank has reached this stage, it may encounter periods of strain involving possible defaults by borrowers. It is, therefore, important to look closely at the various forms this strain will take and analyze the ultimate effects upon the Bank's securities.

In the first place, defaults to the International Bank are unlikely to be complete. Amortization may be postponed or interest may be paid only in the local currency of the borrower. Arrangements of this nature for three-year periods are contemplated in the Bank's Articles of Agreement. If the defaults are of an isolated nature, not occasioned by over-all world conditions, the Bank might work the matter out over a period of time with the borrowing nation, and if the settlement should be at less than 100 cents on the dollar, the loss to the Bank would be of such a minor nature that it could be handled by charging the special reserve and retiring an appropriate amount of the Bank's own outstanding obligations. Suppose, however, that there is a persistent world condition occasioning a substantial number of defaults. Even under these conditions, one cannot assume that all borrowers would default, or that all defaults would be complete. Certainly, it would be only after repeated years of depressed world conditions that the Bank's income from interest and amortization and commissions would be drastically reduced. During this period, dollars on hand and the investments in the special reserve fund would provide the Bank with a considerable amount of liquid assets with which to meet payments on its debentures and guaranteed securities. In the pro forma statement above, the total of these two assets amounts to more than 10 per cent of the total obligations of the Bank to in-

investors. For example, service amounting to 6 per cent annually (interest and amortization charges) on five billion dollars of the Bank's obligations could be maintained, without calling on the Bank's unpaid capital, for a period of three years.

Let it be assumed now that the depressed world conditions referred to earlier have continued and that the Bank's gold and dollar liquid assets on hand have been expended. At this point, the Bank would turn to its capital subscribed but not paid in. The debt record of the member countries provides an interesting criterion by which to measure the soundness of the Bank's capital. The United States and Canada, which have subscribed 45.6 per cent of the capital, enjoy the highest credit in the world. The sterling group (United Kingdom, India, Union of South Africa, and Egypt) has never defaulted on any of its publicly-held obligations, external or internal. This group has subscribed to 24.0 per cent of the capital. Western European countries, with 13.2 per cent of the subscribed capital, have the same record on their obligations. The remaining 17.2 per cent is subscribed by the remaining countries, and among these are quite a few whose debt history is very good. On the basis of past performance, the Bank's capital resources appear to be of high quality.

The uncalled 80 per cent of the 3,175 million dollar capital subscription of the United States is available without further legislative action, to meet such calls as may be issued by the Bank in accordance with its Articles of Agreement. Subsection (b) of Section 7 of Public Law 171 of the 79th Congress (Bretton Woods Agreements Act) reads as follows:

> "The Secretary of the Treasury is authorized to pay the balance of $950,000,000 of the subscription of the United States to the Fund not provided for in subsection (a) and to pay the subscription of the United States to the Bank from time to time when payments are required to be made to the Bank. For the purpose of making these payments, the Secretary of the Treasury is authorized to use as a public-debt transaction not to exceed $4,125,000,000 of the proceeds of any securities hereafter issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act are extended to include such purpose. Payment under this subsection of the subscription of the United States to the Fund or the Bank and repayments thereof shall be treated as public-debt transactions of the United States."

Furthermore, the obligation of each member on its subscription to the capital of the Bank is independent of the obligations of other members and in case some members fail to respond to a call on their subscriptions, the Bank may continue to make pro rata calls, up to the full amount of its capital subscribed and unpaid, until the amount received by the Bank is sufficient to meet its obligations for funds borrowed by it or on guarantees made by it.

It is reasonable to assume that a call of capital to meet current debenture needs would hardly exceed 5 per cent per annum, given an appropriate staggering of maturities and long-term obligations, and this fact greatly increases the prospect that member countries will be able to meet these calls. For example, the United Kingdom might be unable to pay 1.3 billion in dollars (her capital subscription) if called in any one year, but it is most unlikely that she would be unable to deliver $65,000,000 or 5 per cent of her capital subscription in any one year. The unlikelihood of such can be further high-lighted by reference to the probable size of the British payments to foreigners in the postwar period, which it is estimated will run around 8 billion dollars annually. Similarly 5 per cent of Belgium's subscription amounts to $11,250,000, while Belgium's assets in the United States amount to some

$694,000,000. Honduras might well fail to produce 1,000,000 U.S. dollars, if called in any one year, but it is highly improbable that it could not muster a payment of 50,000 dollars. It should be observed also that a large majority of the Bank's capital is subscribed by countries that are not likely to be borrowers or by countries that are very unlikely to be in default on their debts.

It has been the purpose in the foregoing paragraphs to conceive of the worst situations, both in terms of global amounts and in terms of time. The factor of time materially strengthens the position of the Bank and of the investors in the Bank's securities, and no analysis which does not take this factor into account can be considered realistic.

However, a balance-sheet analysis omitting the time factor can be made. Summing up the assets shown in the pro forma balance sheet previously set forth, it is seen that the total of the special reserve fund investments and U. S. dollars on hand, plus 80 per cent of the U. S. capital subscription, amounts to 3.4 billion dollars, definitely and certainly available in U. S. dollars without recourse to any other government. Omitting the problem of interest, this sum will take care of more than 40 per cent of the Bank's total obligations to investors, leaving 4.6 billion dollars of obligations to be met in other ways. Against these obligations, the Bank would have its loan portfolio of 8.5 billion dollars, 3.9 billion dollars of capital subscribed by other countries, and 0.7 billion dollars of other currencies which, for this purpose, the members have agreed would be convertible into dollars. This is a total of 13.1 billion dollars in promises of members to pay in dollars. In other words, promises to pay of members other than the United States would cover the Bank's obligations by a ratio of slightly more than 2.8 to 1. If the Bank had outstanding only 6 billion dollars in debentures and 6 billion dollars in loans, this ratio would rise to better than 4 to 1. Such coverage would go far beyond anything which past experience or future expectations would lead one to believe necessary.

In assessing the significance of this great margin of coverage for the Bank's bonds, it is useful to consider analytically the record of the foreign loans in the past. The errors of foreign lending in the twenties are unlikely to be repeated; not only are the lessons to be learned from that period still fresh in mind, but many safeguards and limitations are written into the Bank's Articles of Agreement to prevent any recurrence in the future. Nevertheless, it may be worth pointing out that the record of returns on these past foreign loans is hardly as black as is sometimes assumed. A recent study by the Bureau of Foreign and Domestic Commerce, covering the period from 1920 through 1940, provides the basis for estimates on the subject. To summarize this study, American investors have gotten out of their portfolio investments (stocks, bonds, etc.) 1.5 billion dollars more than they have put into such investments. Direct investments by Americans have made an even better showing, the excess in this case amounting to 7.2 billion dollars. A table containing additional details on the foregoing is appended. Even though the record on portfolio investments during this period was not brilliant, a return of even these proportions would be far more than needed by the International Bank in order to protect its bondholders from any loss.

It has been sought in the foregoing paragraphs to demonstrate the great economic stress the Bank is designed to withstand, and what this inherent strength means to holders of the Bank's obligations. Certainly, should any such condition as those premised in this paper occur, the record the securities of the Bank would make would compare very favorable with the record of other securities during the same period.

Perhaps not sufficient attention has been focused on the very real prospects that the Bank may operate with few, if any, calls on its capital. Certainly, this would be the measure of complete success. The Bank and its members expect this to occur, and operations based on anything less than this goal would not agree with the spirit of the institution. The Bank, however, is merely a part of the world economic scheme. The futures of the United Nations, the International Monetary Fund, the proposed International Trade Organization, are closely related to the success of the Band as an international lending organization. Proper world trade policies, exchange stabilization, and political stability are important to the Bank and the organizations named are directly concerned with them. These are significant matters, and failure in these fields may mean the Bank will lose some part of its capital. Nevertheless, the investors in the Bank's obligations should suffer no financial loss.

Private foreign investment experience of the United States 1920 - 1940 1/
(in billions of dollars)

	Portfolio Investments (Stocks, bonds, etc.)	Direct investments	Total
1. What the United States put in:			
Estimated investments abroad at end of 1919	2.6	3.9	6.5
Net new investments abroad from 1920 through 1940 (gross new investments abroad of 11.8 billion dollars less amortization receipts on foreign dollar bonds and net resales of foreign securities to foreigners of 4.9 million)	3.6	3.3	6.9
Total	6.2	7.2	13.4
2. What the United States got out:			
Value of investments abroad at end of 1940	2.8	7.0	9.8
Income payments received on investments abroad from 1920 through 1940	4.9	7.4	12.3
Total	7.7	14.4	22.1
3. Excess of what the United States got out over what the United States put in	1.5	7.2	8.7

1/ Includes investments in Canada.

Source: Testimony of Wayne C. Taylor before House of Representatives' Committee on Banking and Currency.

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by

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United States Director of the
International Bank for
Reconstruction and Development

THE INTERNATIONAL BANK AND ITS SECURITIES

Before the Convention
of the
INVESTMENT BANKERS ASSOCIATION

December 3, 1946

THE INTERNATIONAL BANK AND ITS SECURITIES

It is particularly fitting to discuss the International Bank for Reconstruction and Development with the members of the Investment Bankers Association since the Bank has been designed to play a direct and important role in the investment machinery of the world. On the one hand, it is a principal purpose of the Bank to promote private foreign investment by means of guarantees of participations in loans and other investments made by private investors; and only when private financing is not available on reasonable terms, to supplement private investment by direct loans. On the other hand, the principal funds to be employed by the Bank in its operations will be derived from the sale on the investment markets of its own obligations or obligations guaranteed by it. If the Bank successfully carries out the responsibilities entrusted to it by its member governments, its securities will within a few years constitute an important factor in the investment markets.

I.

The International Bank has been established pursuant to Articles of Agreement formulated in July 1944 at the Bretton Woods Conference which also prepared the Agreement for the International Monetary Fund. United States participation was authorized by the Bretton Woods Agreements Act which was adopted in the summer of 1945, at which time also, the lending authority of the Export-Import Bank was expanded by $2.8 billion to enable it temporarily to undertake many of the responsibilities of financing reconstruction and development which the International Bank was designed ultimately to assume. The Congress authorized the President to accept membership in the Bank, and undertake on behalf of the United States, the obligations embodied in the Articles of Agreement; it fully empowered the Secretary of the Treasury to pay in dollars to the Bank to meet calls on the capital of $3,175,000,000 subscribed by the United States; it provided for the appointment of a United States Governor and an Executive Director and their alternates by the President by and with the advice and consent of the Senate; it created a National Advisory Council—known as the NAC which consists of the Secretary of the Treasury as Chairman, the Secretaries of State and of Commerce, and the Chairmen of the Board of Governors of the Federal Reserve System and of the Board of Directors of the Export-Import Bank—to act for the United States in matters such as:

1. Assenting to the sale of debentures in this country where the approval of the Government of the United States is required.
2. To give policy guidance to the representatives of the United States in the Bank and Fund.
3. To coordinate the participation of the United States in these international financial institutions with the foreign financial operations of the United States agencies such as the Export-Import Bank, the Treasury, etc.
4. To render periodic reports and recommendations to the Congress regarding the operations of the Bank and Fund.

The Congress also provided certain status, rights, and immunities to the Bank—for example, the Bank may sue and be sued in district courts of the United States.

Other countries followed suit and by December 27, 1945 sufficient countries had accepted the Articles of Agreement to put them into effect. The Bank now has 38 members. Seven other nations which were represented at Bretton Woods are eligible to join at any time prior to December 31 of 1946; two of them, Australia and Colombia, have authorizing legislation before their parliaments. Four others, Turkey, Syria, Lebanon, and Italy, were recently made eligible for membership and may be expected to complete the formalities in the next month or so.

The Bank is governed by two bodies, a Board of Governors in which is vested all powers, and the Executive Directors who are responsible for the conduct of the general operations of the Bank. Each member government appoints a Governor and Alternate Governor and most countries have followed the practice of the United States of appointing the same persons to both the Bank and Fund. The United States Governor is the Secretary of the Treasury, Mr. John Snyder, and his alternate is the Under Secretary of State for Economic Affairs, Mr. William L. Clayton. Other countries have generally appointed their Ministers of Finance or the heads of their central banks.

The Board of Governors met initially in Savannah last March, provided organizational and administrative procedures and regulations, delegated full operating authority to the Executive

Directors, and elected the seven elective Executive Directors. The Governors held their first regular annual meeting at Washington in September.

There are twelve Executive Directors, one representing each of the five largest subscribing nations and seven elected by the Governors for the other member nations. Among the Executive Directors are many who have served in high posts in public and private financial institutions. The Executive Directors act as a board under the chairmanship of a President whom they have elected and who has no vote except in case of tie. They have been meeting regularly twice a week since May 7 at the offices of the Bank in Washington. Voting in both the Board of Governors and the Executive Directors is based on the subscriptions of individual countries.

The President, under the direction and control of the Executive Directors, is the chief executive officer of the Bank. In June Mr. Eugene Meyer was elected President, and he has brought together a carefully selected staff including Mr. Harold D. Smith, former Director of the Budget, as Vice President; Mr. Chester McLain of a prominent New York law firm, as General Counsel; Mr. Charles Pineo, formerly of the Royal Bank of Canada, as Loan Director; Mr. Crena de Iongh, formerly head of one of the largest Dutch banks, as Treasurer; Mr. Leonard Rist, formerly of Morgan & Company, Paris, as Director of Research; and Mr. Morton Mendels, a Canadian lawyer, as Secretary.

The Bank has organized; it has called up capital; it has received and is considering certain loan applications; it is considering the marketing of its own obligations. It is, in short, a going concern.

II.

Let us consider the loan operations of the Bank.

The principal purposes of the Bank are:

1. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war; the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment, as I have already stated, and

3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by the encouraging international investment for the development of the productive resources of members; thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.

For these purposes the Bank may make or participate in direct loans or guarantee in whole, or in part, loans made by private investors through the usual investment channels for the exclusive benefit of its own members. Such loans shall be subject to the following conditions:

1. When the member in whose territories the project is located is not itself a borrower, the member or the central bank or some comparable agency of the member which is acceptable to the Bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan.

2. The Bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower.

3. A competent committee, including members of the staff of the Bank and a representative of the applicant, has submitted a written report recommending the project after a careful technical, engineering, and economic study of the merits of the proposal.

4. In the opinion of the Bank the rate of interest and other charges are reasonable and such rate, charges and the schedule for repayment of principal are appropriate to the project.

5. In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole.

6. In guaranteeing a loan made by other investors, the Bank receives suitable compensation for its risk.

7. Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development.

Moreover, the Bank shall make supervisory arrangements to ensure that the proceeds of any loan are used efficiently and only for the purposes for which the loan was granted.

These provisions will result in carefully considered loans of a productive character designed to increase levels of economic activity in the member nations, and to facilitate repayment by the borrowers.

The Bank has already announced the receipt of loan applications or letters of intent from Chile, Denmark, France, Poland, the Netherlands, Czechoslovakia, Luxembourg, and Iran. These requests cover both reconstruction programs and developmental projects. They cover only the financing of acquisitions abroad of materials and equipment and not local currency financing of labor and other local costs. They cover a range of maturities of from ten or twelve to twenty-five years. All loans of the Bank will be subject to regular amortization.

Loan committees are actively considering three of the applications. No loan decisions have as yet been taken.

A number of these applications had previously been brought to the attention of the Export-Import Bank. In a report to the Congress of last March the NAC indicated that the International Bank would be the principal agency to make foreign loans for reconstruction and development which private capital cannot furnish on reasonable terms. Pending the effective operation of the International Bank, the Export-Import Bank has extended such credits limited necessarily to the immediate minimum needs of the borrowers. With the coming into effective operation of the International Bank it is the policy of the United States in general to withdraw the Export-Import Bank from the business of making emergency long-term loans for reconstruction and development programs and projects. The Export-Import Bank has been so informing applicants for this type of financial assistance.

In the making and implementing of loans the Bank is prohibited by its Articles of Agreement from interfering in the political affairs of any member, nor shall it be influenced by the political character of the member or members concerned. Only economic considerations shall be relevant to its decisions, and these considerations shall be weighed impartially in order to achieve the purposes of the Bank which I have mentioned earlier. I am certain that all of the member governments will direct their representatives to act on loan projects on the basis of such economic considerations alone.

Among the principal purposes of the Bank is the promotion of the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments, conditions which are important if the borrower is to be in a position to meet its obligations to the Bank. I believe that the Executive Directors of the Bank must, therefore, in passing on an individual loan application, give careful attention not only to the details of the particular project but must consider their relation to the broad trade, financial, and investment policies of the borrower as the latter might affect the useful carrying out of the project and the prospects of repayment of the loan. We intend that the loans of the Bank shall be sound and shall be repaid. The Bank must avoid any political activity. But where policies of a borrower have important economic consequences bearing on the satisfactory attainment of the purposes of the Bank and the repayment of its loans; such policies and such economic consequences thereof, I feel, must be given careful consideration in passing on the application.

III.

Let us turn to the financial side of the Bank. The authorized capital of the Bank is $10 billion. The subscriptions of the present 38 members amount to $7.7 billion. With the addition of the six likely countries I mentioned earlier, the capital subscribed would rise to about $8 billion.

The Bank is authorized to call up 20 percent of its subscribed capital to serve as working funds. The other 80 percent may be called only as needed to enable the Bank to meet interest and amortization requirements of its own obligations to private investors.

The first 2 percent has already been paid in gold or dollars and an additional 8 percent in the local currency of each member. The Bank has announced its intention to call up the second 10 percent of its capital in two further installments by May 1947. In this manner the Bank has already received some $150 million representing the 2 percent portion which it has invested largely in short-term obligations of the U. S. Treasury. By May of next year it will have available about $720 million of U.S. dollar funds,

some $80 million of Canadian and other funds immediately usable in loan operations, and the equivalent of almost $800 million more in currencies not readily available for current loans although usable for such administrative expenditures as the Bank may incur in such currencies.

The Bank will thus have perhaps $800 million of its own funds available for loans. For operations in larger amounts, and in order to replenish its working balances, it must have recourse to the private capital markets. It is anticipated that eventually the Bank will market its securities in a number of foreign markets —especially European—which have traditionally financed international investment. Exchange and balance of payments situations make it unlikely that any significant volume of securities may be placed in such markets in the transition period of reconstruction, and therefore the Bank must look at the outset to investment outlets in the United States and perhaps Canada.

The authorities of the United States have interested themselves in efforts to broaden potential U. S. markets for the obligations of the International Bank. Legislation legalizing such obligations has been suggested in the Federal-State legislative program of the Council of State Governments and the Department of Justice. The NAC has recommended action to legalize the obligations of the Bank for investment by insurance companies in the District of Columbia. Action in this field forms a part of the legislative programs of a number of national and state associations of financial institutions. Finally, a number of us representing the United States, have held meetings with the principal investing institutions and state authorities in many parts of the country. It is, of course, too early to predict the final outcome but present indications suggest that we may confidently await action during the course of the next legislative sessions for most of the principal classes of investors in the states in which large investment funds exist.

The present status of eligibility may be briefly summarized.

Commercial banks in the United States, with capital and surplus of well over $7 billion, may generally invest up to 10 percent of their capital and surplus in securities of investment quality of a single issuer. No legal barriers exist in the case of national banks provided that certain requirements of the bank supervisory authorities are met. But in twelve states representing some 6 percent of the total capital and surplus of all banks, no investment by state banks is now permitted.

Mutual savings banks, with total assets of about $17 billion, exist in 17 states. In four of these, having 62 percent of the total assets, investment in the obligations of the International Bank is now permitted. The principal one is, of course, New York, where eligilibility legislation was enacted at the last session of the legislature.

Insurance companies in virtually all of the states having an important volume of insurance assets, are now barred from investing in the obligations of the Bank. Total assets of life insurance companies run to some $44 billion.

Trusts are in most jurisdictions permitted to acquire the obligations of the International Bank unless specific restrictions are incorporated in the instruments establishing the individual trusts.

Much interest has been displayed by the financial community in the probable size and timing of issues of the Bank, their terms and conditions, and the machinery for their distribution. These are matters on which decisions by the Bank have not yet been taken. As I have indicated, the Bank has already available an important amount of dollar resources, and more will be available by next May. Its consideration of loan applications is proceeding, but no commitments have yet been entered into. The rate of expenditure of loans lags very greatly behind the signature of loan contracts, due to delays in obtaining delivery of materials and equipment. So the actual need of the Bank for funds for actual loan expenditures will not be pressing for some time.

On the other hand, the Bank will certainly wish to maintain sizeable working balances, and will, therefore, wish to replenish, in considerable measure, its own funds as they are drawn upon. This, of course, will also provide a certain testing of the market.

IV.

I believe you would be interested in some more detailed analysis of the obligations of the Bank.

Although the Bank may guarantee the direct obligations of its members, it is not believed that at the outset at least, this will be the principal method of financing reconstruction and development. It may be expected that the principal business of the Bank will be the direct lending of its own funds and funds raised by the sale of its own obligations.

Such securities will be general obligations of the Bank, secured by the general assets of the Bank rather than by the pledge of of specific assets.

The Bank, though not strictly speaking a corporation since it is not incorporated under the corporation laws of any U. S. jurisdiction, is a legal entity with most of the usual attributes of a corporation bestowed by international agreement implemented by the domestic legislation of the members.

The Bank may make loans or guarantees only to the extent of 100 percent of its unimpaired subscribed capital, reserves, and surplus—at the present time $7.7 billion. This automatically fixes the amount of its own obligations which the Bank may usefully issue. This also ensures that the Bank at all times will have at least twice as many assets as obligations to private investors—its loan portfolio plus its cash, segregated reserves, and unpaid capital subscriptions.

The Bank will apply for registration of the Bank's bonds with the SEC, and it will apply for listing of the bonds on the major exchanges. The bonds may be issued in the United States only with the approval of the NAC. They will probably be issued in more than one maturity ranging from perhaps 10 years to 20 or 25 years, and at least the longer maturities will be subject to amortization.

The bonds of the Bank will *not* be United States bonds, nor will they be guaranteed by the United States. They *will* be very well secured by the substantial assets of the Bank, by the conservative provisions of the Articles of Agreement, and by the competence of the management.

The Bank is, in fact, a source of mutual assistance at two levels. On the one, all of its members band together and subscribe important sums of capital to facilitate loans to certain of the members. The creditor and debtor nations alike stand behind the obligations of the Bank to the limit of their subscriptions. On the other level, the borrowers contribute a fee of one to one and a half percent per annum on the outstanding principal of their loans to a sort of insurance fund called the Special Reserve which must be segregated in liquid assets such as U. S. Treasury obligations and which may be used only to meet contractual charges on the Bank's own obligations.

Under any, even fairly normal, general international economic conditions the Bank may expect sporadic suspensions of amortization and possibly interest on particular loans due to local circumstances of the borrower. If these do not occur the loan portfolio will more than adequately meet the requirements of servicing the Bank's debentures. Even if they occur on a reasonably large scale, the Special Reserve or insurance fund created for the very purpose, should carry the Bank through comfortably with no necessity to impair its own capital.

But let us assume the worst sort of conditions—a deepening, protracted world-wide slump. The Special Reserve and other dollar cash funds of the Bank should be great enough to meet the interest and amortization on dollar obligations for a number of years. If the depression or other world-wide economic disturbance is further protracted; the Bank may call on its subscribers for the 80 percent of capital not originally paid in, and it may require payment in the currencies needed to meet its obligations. The United States share alone is an additional $2.5 billion. Thus, it may be demonstrated that the Bank would hold total quick dollar assets and claims against the U. S. Government amounting to almost half the Bank's total obligations at a fully-loaned up position. In addition it holds claims against other governments in the form of the loan portfolio, the 80 percent capital, and the miscellaneous foreign currency cash—all convertible in the terms of the Agreement into dollars or whatever other currency is needed by the Bank, to the extent of almost three times the remaining obligations.

Let me digress to point out that the Bank will not incur any risks of currency depreciation. Its loans out of the proceeds of the sale of debentures must be denominated in the same currencies as the debentures. Also its local currency capital must be maintained by the members at the equivalent in U. S. dollars of 1944.

The foreign members of the Bank include a number of nations whose debt records are outstanding. If we except the first World War obligations, Canada, the United Kingdom, the other British Dominions, Scandinavian countries, Western Europe, and a number of other members whose capital sub-

scriptions, with that of the United States, make up more than 85 percent of the total have never failed to meet all contractual debt service. And the records of many of the others are quite good even though not perfect.

The factor of time further improves the analysis.

Since the service on the Bank's bonds will be spread over many years, annual requirements are not great. It is unlikely that capital calls of more than two or three percent would be required in any one year and it is certainly not likely that a call of more than five percent could ever be required in one year. The demands on members would thus never be a large fraction of their current balance of payments or their reserves of gold and dollars.

This whole analysis would, of course, be appreciably altered and the security behind the bonds improved if the Bank were not in fact, fully loaned up; or if a portion of its operations were in currencies other than dollars. Moreover, with the operations of the International Monetary Fund and the prospective International Trade Organization, the position of the Bank would be correspondingly strengthened.

I believe that this analysis demonstrates that at all times there should be ample security to protect holders of the obligations of the International Bank.

V.

I have devoted this discussion to a very detailed presentation of the financial picture of the International Bank and its obligations since I have felt that you as members of the Investment Bankers Association would be particularly interested in such specific matters. I should like to conclude with a few observations about the relation of all this to the foreign economic policy of the United States.

I believe that you will all agree with me that the immediate and long-term interests of the United States require the speeding up of the world's economic recovery and economic development through a continuous and steady flow of foreign loans. Only by the reestablishment of high levels of production and trade the world over can the United States be assured in future years of a sustained level of exports and imports appropriate to the maintenance of high levels of domestic production and employment. By facilitating the sound economic development of other areas, the levels of world production and income can be increased. High levels of income at home and abroad are the surest foundations to the expansion of world trade which is necessary to us and to the rest of the world—the surest foundations upon which to build prosperity and peace.

The United States has utilized a number of vehicles for the emergency and transitional financing of relief, rehabilitation, and reconstruction. It is its present policy, fully ratified by the Congress, to place principal emphasis on the International Bank as the instrument for the promotion of private foreign investment and the supplemental financing at long-term of projects and programs of reconstruction and development.

Speech Series # 7

Statement by

EMILIO G. COLLADO

United States Executive Director
of the International Bank for
Reconstruction and Development

to the

Insurance Committee of the Legislature
of the Commonwealth of Massachusetts

January 21, 1947

INTRODUCTION

The immediate and long-term interests of the United States require speeding up of the world's economic recovery and economic development through a continuous and steady flow of foreign loans. Only by the re-establishment of high levels of production and trade the world over can the United States be assured in future years of a sustained level of exports and imports appropriate to the maintenance of high levels of domestic production and employment. By facilitating the sound economic development of other areas, the levels of world production and income can be increased. High levels of income at home and abroad are the surest foundations to the expansion of world trade which is necessary to us and to the rest of the world—the surest foundations upon which to build prosperity and peace.

The United States has utilized a number of vehicles for the emergency and transitional financing of relief, rehabilitation, and reconstruction. It is its present policy, fully ratified by the Congress, to place principal emphasis on the International Bank for Reconstruction and Development as the instrument for the promotion of private foreign investment and the supplemental financing at long-term of projects and programs of reconstruction and development.

The principal funds to be employed by the Bank in its operations will be derived from the sale on the investment markets of its own obligations or obligations guaranteed by it. In many jurisdictions various types of investors may now invest in the obligations of the Bank. The New York State Assembly last March legalized such obligations for investment by mutual savings banks. Legislation is now being introduced in a number of States to make International Bank obligations eligible for insurance company and other investment.

There are two general reasons why it is important that the market for the obligations of the International Bank be broadened as much as possible: First, the Bank must distribute its securities widely if the responsibilities in the foreign economic field entrusted to it by the United States and other

member governments are to be adequately discharged. Second, the obligations of the Bank will provide a safe and attractive outlet for investment funds.

There are two particular reasons why it is important that the obligations of the International Bank be made eligible for investment by Massachusetts insurance companies: First, such companies constitute an important factor in the total investment market. Second, the example of Massachusetts is important in influencing investment policies in other states.

It is believed that the following analysis will demonstrate the high investment quality of the obligations of the International Bank.

HISTORY AND ORGANIZATION

The International Bank has been established pursuant to Articles of Agreement formulated in July 1944 at the Bretton Woods Conference which also prepared the Agreement for the International Monetary Fund. United States participation was authorized by the Bretton Woods Agreements Act which was adopted in the summer of 1945, at which time also, the lending authority of the Export-Import Bank was expanded by $2.8 billion to enable it temporarily to undertake many of the responsibilities of financing reconstruction and development which the International Bank was designed ultimately to assume. The Congress authorized the President to accept membership in the Bank, and undertake on behalf of the United States, the obligations embodied in the Articles of Agreement; it fully empowered the Secretary of the Treasury to pay in dollars to the Bank to meet calls on the capital of $3,175,-000,000 subscribed by the United States; it provided for the appointment of a United States Governor and an Executive Director and their alternates by the President by and with the advice and consent of the Senate; it created a National Advisory Council—known as the NAC which consists of the Secretary of the Treasury as Chairman, the Secretaries of State and of Commerce, and the Chairman of the Board of Governors of the Federal Reserve System and of the Board of Directors of the Export-Import Bank—to act for the United States in matters such as:

1. Assenting to the sale of debentures in this country where the approval of the Government of the United States is required.
2. To give policy guidance to the representatives of the United States in the Bank and Fund.
3. To coordinate the participation of the United States in these international financial institutions with the foreign financial operations of the United States agencies such as the Export-Import Bank, the Treasury, etc.
4. To render periodic reports and recommendations to the Congress regarding the operations of the Bank and Fund.

The Congress also provided certain status, rights, and immunities to the Bank—for example, the Bank may sue and be sued in district courts of the United States.

Other countries followed suit and by December 27, 1945 sufficient countries had accepted the Articles of Agreement to put them into effect. The Bank now has 40 members. Four nations, Turkey, Syria, Lebanon, and Italy, were recently made eligible for membership and may be expected to complete the formalities in the next month or so.

The Bank is governed by two bodies, a Board of Governors in which is vested all powers, and the Executive Directors who are responsible for the conduct of the general operations of the Bank. Each member government appoints a Governor and Alternate Governor and most countries have followed the practice of the United States of appointing the same persons to both the Bank and Fund. The United States Governor is the Secretary of the Treasury, Mr. John Snyder, and his alternate is the Under Secretary of State for Economic Affairs, Mr. W. L. Clayton. Other countries have generally appointed their Ministers of Finance or the heads of their central banks.

The Board of Governors met initially in Savannah last March, provided organizational and administrative procedures and regulations, delegated full operating authority to the Executive Directors, and elected the seven elective Executive Directors. The Governors held their first regular annual meeting at Washington in September.

There are twelve Executive Directors, one representing each of the five largest subscribing nations and seven elected by the Governors for the other member nations. Among the Executive Directors are many who have served in high posts in public and private financial institutions. The Executive Directors act as a board under the chairmanship of a President whom they have elected and who has no vote except in case of tie. They have been meeting regularly twice a week since May 7 at the offices of the Bank in Washington. Voting in both the Board of Governors and the Executive Directors is based on the subscriptions of individual countries.

The President is the chief of the operating staff of the Bank and, under the direction of the Executive Directors, conducts the ordinary business of the Bank. Subject to the general control of the Executive Directors, he is responsible for the organization, appointment and dismissal of the officers and staff of the Bank.

The Bank has organized; it has called up capital; it has received and is considering certain loan applications; it is considering the marketing of its own obligations. It is, in short, a going concern.

LOAN OPERATIONS

The principal purposes of the Bank are:

1. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war; the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of

living and conditions of labor in their territories.

4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.
5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

For these purposes the Bank may make or participate in direct loans or guarantee in whole, or in part, loans made by private investors through the usual investment channels for the exclusive benefit of its own members. Such loans shall be subject to the following conditions:

1. When the member in whose territories the project is located is not itself a borrower, the member or the central bank or some comparable agency of the member which is acceptable to the Bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan.
2. The Bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower.
3. A competent committee, including members of the staff of the Bank and a representative of the applicant, has submitted a written report recommending the project after a careful technical, engineering, and economic study of the merits of the proposal.
4. In the opinion of the Bank the rate of interest and other charges are reasonable and such rate, charges and the schedule for repayment of principal are appropriate to the project.
5. In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole.

6. In guaranteeing a loan made by other investors, the Bank receives suitable compensation for its risk.
7. Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development.

Moreover, the Bank in the administration of a loan shall make arrangements:

1. To ensure that the proceeds of the loan are used efficiently and only for the purposes for which it was granted.
2. To ensure that the project for which the loan was granted will accomplish the purposes of the loan.
3. To ensure that the service of the loan can and will be maintained.

These provisions will result in carefully considered loans of a productive character designed to increase levels of economic activity in the member nations, and to facilitate repayment by the borrowers.

The Bank has already announced the receipt of loan applications or letters of intent from Chile, Denmark, France, Poland, the Netherlands, Czechoslovakia, Luxembourg, and Iran. These requests cover both reconstruction programs and developmental projects. They cover only the financing of acquisitions abroad of materials and equipment and not local currency financing of labor and other local costs. They cover a range of maturities of from ten or twelve to twenty-five years. All loans of the Bank will be subject to regular amortization.

Loan committees are actively considering the applications of France, Denmark, and Chile, which have been supported by extensive documentation, and loan decisions may be expected in the coming weeks.

A number of these applications had previously been brought to the attention of the Export-Import Bank. In a report to the Congress of last March the NAC indicated that the International Bank would be the principal agency to make foreign loans for reconstruction and development which private capital cannot furnish on reasonable terms. Pending the effective operation of the International Bank, the Export-Import Bank has extended such credits limited necessarily to the immediate minimum needs of the borrowers. With the coming into effective operation of the International Bank it is the policy of the United States in general to withdraw the Export-Import Bank from the business of making emergency long-term loans for reconstruction and development programs and projects. The Export-Import Bank has been so informing applicants for this type of financial assistance.

In the making and implementing of loans the Bank is prohibited by its Articles of Agreement from interfering in the political affairs of any member, nor shall it be influenced by the political character of the member or members concerned. Only economic considerations shall be relevant to its decisions, and these considerations shall be weighed impartially in order to achieve the purposes of the Bank which have been mentioned earlier.

Among the principal purposes of the Bank is the promotion of the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments, conditions which are important if the borrower is to be in a position to meet its obligations to the Bank. The Executive Directors of the Bank must, therefore, in passing on an individual loan application, give careful attention not only to the details of the particular project but must consider their relation to the broad trade, financial, and investment policies of the borrower as the latter might affect the useful carrying out of the project and the prospects of repayment of the loan. It is intended that the loans of the Bank shall be sound and shall be repaid. The Bank must avoid any political activity. But where policies of a borrower have important economic consequences bearing on the satisfactory attainment of the purposes of the Bank and the repayment of its loans; such policies and such economic consequences thereof must be given careful consideration in passing on the application.

FINANCIAL STRUCTURE

The authorized capital of the Bank is $10 billion. The subscriptions of the present 40 members amount to $7.8 billion. With the addition of the four additional countries mentioned earlier, the capital subscribed would rise to about $8 billion.

The Bank is authorized to call up 20 percent of its subscribed capital to serve as working funds. The other 80

percent may be called only as needed to enable the Bank to meet interest and amortization requirements of its own obligations to private investors.

The first 2 percent has already been paid in gold or dollars and an additional 8 percent in the local currency of each member. A further 5 percent has been called for payment by February 25, 1947, and the Bank has announced its intention to call up another 5 percent by May 1947. In this manner the Bank has already received some $150 million representing the 2 percent portion which it has invested in short-term obligations of the U. S. Treasury. By May of next year it will have available about $720 million of U. S. dollar funds, some $80 million of Canadian and other funds immediately usable in loan operations, and the equivalent of almost $800 million more in currencies not readily available for current loans although usable for such administrative expenditures as the Bank may incur in such currencies.

The Bank will thus have perhaps $800 million of its own funds available for loans. For operations in larger amounts, and in order to replenish its working balances, it must have recourse to the private capital markets. It is anticipated that eventually the Bank will market its securities in a number of foreign markets—expecially European—which have traditionally financed international investment. Exchange and balance of payments situations make it unlikely that any significant volume of securities may be placed in such markets in the transition period of reconstruction, and therefore the Bank must look at the outset to investment outlets in the United States and perhaps Canada.

The authorities of the United States have interested themselves in efforts to broaden potential U. S. markets for the obligations of the International Bank. Legislation legalizing such obligations has been suggested in the Federal-State legislative program of the Council of State Governments and the Department of Justice. The NAC has recommended action to legalize the obligations of the Bank for investment by insurance companies in the District of Columbia. Action in this field forms a part of the legislative programs of a number of national and state associations of financial institutions. Finally, meetings have been held with the principal investing institutions and state authorities in many parts of the country. It is, of course, too early to predict the final outcome but present indications suggest that action may be expected during the course of the present legislative sessions for many of the principal classes of investors in the states in which large investment funds exist.

The present status of eligibility may be briefly summarized.

Commercial banks in the United States, with capital and surplus of well over $7 billion, may generally invest up to 10 percent of their capital and surplus in securities of investment quality of a single issuer. No legal barriers exist in the case of national banks provided that certain requirements of the bank supervisory authorities are met. But in twelve states representing some 6 percent of the total capital and surplus of all banks, no investment by state banks is now permitted.

Mutual savings banks, with total assets of about $17 billion, exist in 17 states. In four of these, having 62 percent of the total assets, investment in the obligations of the International Bank is now permitted. The principal one is, of course, New York, where eligibility legislation was enacted at the last session of the legislature.

Insurance companies in many of the states having an important volume of insurance assets, are now barred from investing in the obligations of the Bank. In certain others it may be possible by administrative or interpretative action to place the obligations of the Bank in legal investment categories.

Total assets of life insurance companies run to some $48 billion.

Trusts are in most jurisdictions permitted to acquire the obligations of the International Bank unless specific restrictions are incorporated in the instruments establishing the individual trusts.

The Bank has determined at all times to maintain a high degree of liquidity against its commitments to its borrowers and to investors in its obligations. This policy will require the holding of cash and other liquid assets, derived from paid-in capital, borrowings, and earnings, sufficient to cover undisbursed loan commitments and to provide resources to meet interest and amortization requirements on its obligations.

OBLIGATIONS OF THE BANK

Although the Bank may guarantee the direct obligations of its members, it is not believed that, at the outset at least, this will be the principal method of financing reconstruction and development. It may be expected that the principal business of the Bank will be the direct lending of its own funds and funds raised by the sale of its own obligations.

Such securities will be general obligations of the Bank, secured by the general assets of the Bank rather than by the pledge of specific assets.

The Bank, though not strictly speaking a corporation since it is not incorporated under the corporation laws of any U. S. jurisdiction, is a legal entity with most of the usual attributes of a corporation bestowed by international agreement implemented by the domestic legislation of the members.

The Bank may make loans or guarantees only to the extent of 100 percent of its unimpaired subscribed capital, reserves, and surplus—at the present time $7.8 billion. This automatically fixes the amount of its own obligations which the Bank may usefully issue. This also ensures that the Bank at all times will have at least twice as many assets as obligations to private investors—its loan portfolio plus its cash, segregated reserves, and unpaid capital subscriptions.

The Bank will apply for registration of the Bank's bonds with the SEC, and it will apply for listing of the bonds on the major exchanges. A first draft of prospectus and registration statement is now being discussed with the SEC.

The bonds may be issued in the United States only with the approval of the NAC. They will probably be issued in more than one maturity ranging from perhaps 10 years to 20 or 25 years, and at least the longer maturities will be subject to amortization.

The bonds of the Bank will not be United States bonds, nor will they be guaranteed by the United States. They will be very well secured by the substantial assets of the Bank, by the conservative provisions of the Articles of Agreement, and by the competence of the management.

In setting up the International Bank to operate in the manner outlined above, it was recognized as essential that the securities that it would issue should be of high quality and fully suitable for investment by institutions and trustees in the United States. The Articles of Agreement were therefore drawn in such a manner that the resources of the Bank—consisting of its outstanding loans plus the securities in its reserve funds, plus the amounts due from member governments on their capital subscriptions—would be quite certain, at all times, to be more than sufficient to cover the Bank's obligations. One outstanding resource of the Bank will be the capital subscription of the United States Government, amounting to 3,175 million dollars. The Bank's other resources will also contribute very important backing for its obligations, as the following discussion will show.

Perhaps the best way to analyze the security behind the Bank's obligations is to set forth, in an over-simplified manner, a pro forma statement of the Bank's prospective position some years hence:

(Millions of Dollars)

ASSETS			LIABILITIES	
Cash and Investments on Hand			Capital Subscribed	$ 8,500
Cash and Investments	$ 900		Surplus	600
Set Aside for Special Reserve	500		Special Reserve	500
	$ 1,400			$ 9,600
Holdings in Currencies Other Than U. S. Dollars	600		Debentures Outstanding and Obligations on Any Guaranteed Loans	7,300
Loans Disbursed (including any guaranteed loans)	8,100		Undisbursed Loan Commitments	500
Loans Undisbursed	500			
Uncalled Subscriptions				
U. S. $2,540				
Other 4,260	6,800			
	$17,400			$17,400

This pro forma statement rests on the following assumptions:

1. Some new members have been admitted, increasing the capital subscribed by $500 million.
2. Sufficient time has elapsed for the Bank to reach a mature loan position with loan contracts continuously amounting to 90 percent of the loan limit and a very small lag of $500 million in loan disbursements. It is unlikely that such high figures for loans committed and disbursed will ever be maintained.
3. Special Reserve has been computed at legal minimum of 1 percent per annum. Surplus has been estimated conservatively. These totals would be reached whether the rate of loan commitment and disbursement is relatively fast, say over an eight-year period, or much slower, say over fifteen or more years.
4. No defaults are incurred on loans—a reasonable assumption during a period in which funds are being disbursed.
5. A small amount of Canadian and other currencies arising from the paid-in capital has been employed in making loans.
6. No securities have been issued except in the United States. To the extent that foreign currency obligations are issued the security behind the dollar obligations of the Bank is increased.

After the Bank has reached this stage, it may encounter periods of strain involving possible defaults by borrowers. It is, therefore, important to look closely at the various forms this strain will take and analyze the ultimate effects upon the Bank's securities.

In the first place, defaults to the International Bank are unlikely to be complete. Amortization may be postponed or interest may be paid only in the local currency of the borrower. Arrangements of this nature for three-year periods are contemplated in the Bank's Articles of Agreement. If the defaults are of an isolated nature, not occasioned by over-all world conditions, the Bank might work the matter out over a period of time with the borrowing nation, and if the settlement should be at less than 100 cents on the dollar, the loss to the Bank would be of such a minor nature that it could be handled by charging the special reserve and retiring an appropriate amount of the Bank's own outstanding obligations. Suppose, however, that there is a persistent world condition occasioning a substantial number of defaults. Even under these conditions, one cannot assume that all borrowers would default, or that all defaults would be complete. Certainly, it would be only after repeated years of depressed world conditions that the Bank's income from interest and amortization and commissions would be drastically reduced. During this period, dollars on hand and the investments in the special reserve fund would provide the Bank with a considerable amount of liquid assets with which to meet payments on its debentures and guaranteed securities. In the pro forma statement above, the total of these two assets amounts to more than 10 percent of the total obligations of the Bank to investors. For example, service amounting to 6 percent annually (interest and amortization charges) on five billion dollars of the Bank's obligations could be maintained, without calling on the Bank's unpaid capital, for a period of three years.

Let it be assumed now that the depressed world conditions referred to earlier have continued and that the Bank's gold and dollar liquid assets on hand have been largely expended. At this point, the Bank would turn to its capital subscribed but not paid in. The debt record of the member countries provides an interesting criterion by which to measure the soundness of the Bank's capital. The United States and Canada, which have subscribed 45.6 percent of the capital, enjoy the highest credit in the world. The sterling group (United Kingdom, India, Union of South Africa, and Egypt) has never defaulted on any of its publicly-held obligations, external or internal. This group has subscribed to 24.0 percent of the capital. Western European countries, with 13.2 percent of the subscribed capital, have the same record on their obligations. The remaining 17.2 percent is subscribed by the remaining countries, and among these are quite a few whose debt history is very good. On the basis of past performance, the Bank's capital resources appear to be of high quality.

The uncalled 80 percent of the 3.175 million dollar capital subscription of the United States is available without further legislative action to meet such calls as may be issued by the Bank in accordance with its Articles of Agreement. Subsection (b) of Section 7 of Public Law 171 of the 79th

Congress (Bretton Woods Agreements Act) reads as follows:

> "The Secretary of the Treasury is authorized to pay the balance of $950,000,000 of the subscription of the United States to the Fund not provided for in subsection (a) and to pay the subscription of the United States to the Bank from time to time when payments are required to be made to the Bank. For the purpose of making these payments, the Secretary of the Treasury is authorized to use as a public-debt transaction not to exceed $4,125,000,000 of the proceeds of any securities hereafter issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act are extended to include such purpose. Payment under this subsection of the subscription of the United States to the Fund or the Bank and repayments thereof shall be treated as public-debt transactions of the United States."

Furthermore, the obligation of each member on its subscription to the capital of the Bank is independent of the obligations of other members, and in case some members fail to respond to a call on their subscriptions, the Bank may continue to make pro rata calls, up to the full amount of its capital subscribed and unpaid, until the amount received by the Bank is sufficient to meet its obligations for funds borrowed by it or on guarantees made by it.

It is reasonable to assume that a call of capital to meet current debenture needs would hardly exceed 5 percent per annum, given an appropriate staggering of maturities and long-term obligations, and this fact greatly increases the prospect that member countries will be able to meet these calls. For example, the United Kingdom might be unable to pay 1.3 billion in dollars (her capital subscription) if called in any one year, but it is most unlikely that she would be unable to deliver $65,000,000 or 5 percent of her capital subscription in any one year. The unlikelihood of such can be further high-lighted by reference to the probable size of the British payments to foreigners in the postwar period, which it is estimated will run around 8 billion dollars annually. Similarly 5 percent of Belgium's subscription amounts to $11.250,000, while Belgium's assets in the United States amount to some $694,000,000. Honduras might well fail to produce 1,000,000 U. S. dollars, if called in any one year, but it is highly improbable that it could not muster a payment of 50,000 dollars. It should be observed also that a large majority of the Bank's capital is subscribed by countries that are not likely to be borrowers or by countries that are very unlikely to be in default on their debts.

The Bank will not incur any risks of currency depreciation. Its loans out of the proceeds of the sale of debentures must be denominated in the same currencies as the debentures. Also its local currency capital must be maintained by the members at the equivalent in U. S. dollars of 1944.

It has been the purpose in the foregoing paragraphs to conceive of the worst situations, both in terms of global amounts and in terms of time. The factor of time materially strengthens the position of the Bank and of the investors in the Bank's securities, and no analysis which does not take this factor into account can be considered realistic.

However, a balance sheet analysis omitting the time factor can be made. Summing up the assets shown in the pro forma balance sheet previously set forth, it is seen that the total of the special reserve fund investments and U. S. dollars on hand, plus 80 percent of the U. S. capital subscription, amounts to 3.9 billion dollars, definitely and certainly available in U. S. dollars without recourse to any other government. Omitting the problem of interest, this sum will take care of more than 50 percent of the Bank's total obligations to investors, leaving 3.4 billion dollars of obligations to be met in other ways. Against these obligations, the Bank would have its loan portfolio of 8.1 billion dollars, 4.2 billion dollars of capital subscribed by other countries, and 0.6 billion dollars of other currencies which, for this purpose, the members have agreed would be convertible into dollars. This is a total of 12.9 billion dollars in promises of members to pay in dollars. In other words, promises to pay of members other than the United States would cover the Bank's obligations by a ratio of 3.8 to 1. Such coverage would go far beyond anything which past experience or future expectations would lead one to believe necessary.

Expressed in another way, at the mature loan position a recovery of only 26 percent on loans and uncalled subscriptions of members other than the United States is required to meet in full the principal of the obligations of the Bank. At an intermediate point with about five billions of loan commitments and say $3.6 billion of funds raised in the market, no recovery whatever on the "foreign" assets of the Bank is required to meet the Bank's principal obligations.

In assessing the significance of this great margin of coverage for the Bank's bonds, it is useful to consider analytically the record of the foreign loans in the past. The errors of foreign lending in the twenties are unlikely to be repeated; not only are the lessons to be learned from that period still fresh in mind, but many safeguards and limitations are written into the Bank's Articles of Agreement to prevent any recurrence in the future. Nevertheless, it may be worth pointing out that the record of returns on these past foreign loans is hardly as black as is sometimes assumed. A recent study by the Bureau of Foreign and Domestic Commerce, covering the period from 1920 through 1940, provides the basis for estimates on the subject. To summarize this study, American investors have gotten out of their portfolio investments (stocks, bonds, etc.) 1.5 billion dollars more than they have put into such investments. Direct investments by Americans have made an even better showing, the excess in this case amounting to 7.2 billion dollars. A table containing additional details on the foregoing is appended. Even though the records on portfolio investments during this period was not brilliant, a return of even these proportions would be for more than needed by the International Bank in order to protect its bondholders from any loss.

It has been sought in the foregoing paragraphs to demonstrate the great economic stress the Bank is designed to withstand, and what this inherent strength means to holders of the Bank's obligations. Certainly, should any such condition as those premised in this paper occur, the record the securities of the Bank would make would compare very favorably with the record of other securities during the same period.

Perhaps not sufficient attention has been focused on the very real prospects that the Bank may operate with few, if any, calls on its capital. Certainly, this would be the measure of complete success. The Bank and its members expect this to occur, and operations based on anything less than this goal would not agree with the spirit of the institution. The Bank, however, is merely a part of the world economic scheme. The future of the United Nations, the International Monetary Fund, the proposed International Trade Organization, are closely related to the success of the Bank as an international lending organization. Proper world trade policies, exchange stabilization, and political stability are important to the Bank and the organizations named are directly concerned with them. These are significant matters, and failure in these fields may mean the Bank will lose some part of its capital. Nevertheless, the investors in the Bank's obligations should suffer no financial loss.

Attachments:

Private Foreign Investment Experience of the United States, 1920-40

Private foreign investment experience of the United States
1920 - 1940 1/
(in billions of dollars)

	Portfolio Investments (Stocks, bonds, etc.)	Direct investments	Total
1. What the United States put in:			
Estimated investments abroad at end of 1919	2.6	3.9	6.5
Net new investments abroad from 1920 through 1940 (gross new investments abroad of 11.8 billion dollars less amortization receipts on foreign dollar bonds and net resales of foreign securities to foreigners of 4.9 million)	3.6	3.3	6.9
Total	6.2	7.2	13.4
2. What the United States got out:			
Value of investments abroad at end of 1940	2.8	7.0	9.8
Income payments received on investments abroad from 1920 through 1940	4.9	7.4	12.3
Total	7.7	14.4	22.1
3. Excess of what the United States got out over what the United States put in	1.5	7.2	8.7

1/ Includes investments in Canada.

Source: Testimony of Wayne C. Taylor before House of Representatives' Committee on Banking and Currency.

Speech Series #7

Mr Donovan reported

2,000 copies ordered of
Collado speech 1/21/47
before Insurance Committee of
the Legislature of the Commonwealth
of Massachusetts