May 23, 1949

Statement of Mr. John J. McCloy, President, International Bank for Reconstruction and Development, before the House Committee on Banking and Currency on H. R. 4332.

Mr. Chairman:

I appreciate the opportunity to appear before this Committee in my capacity as President of the International Bank for Reconstruction and Development. We in the Bank look upon the House Banking and Currency Committee as an old friend. Both you, Mr. Chairman, and Mr. Wolcott were members of the United States delegation at the Bretton Woods Conference, and it was this Committee that reported out the Bretton Woods Agreements Act pursuant to which the United States accepted membership in the Bank.

As you know, the National Advisory Council has proposed to the Congress legislation to amend the Bretton Woods Agreements Act and the National Bank Act in order to facilitate the operations of the International Bank. The bill would permit national banks to deal in the bonds of the International Bank and thus broaden the market for the bonds. It would also exempt securities issued or guaranteed by the Bank from the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and thus facilitate the distribution of those securities. The broadening of the market for the Bank's bonds in these ways is important to the Bank and, in my judgment, would be in the best interests of the United States for reasons which I shall briefly present to you.

This Committee is familiar with the organization and purposes of the International Bank. It has been in existence now for nearly 3½ years. It has 48 member countries, including most of the important countries of the world. Of the countries participating in the Bretton Woods Conference, Russia is the notable exception. Some countries not represented at Bretton Woods - Austria, Finland, Italy, Lebanon, Syria, Siam and Turkey - have also become members.

The Bank has proved itself to be an effective instrument of international cooperation. The Board of Executive Directors of the Bank is now composed of 14 members all of different nationalities but all of whom display the same objectivity and soundness of approach in dealing with the questions of policy which are presented to them. It has an international staff composed of 22 nationalities, which functions with great objectivity and soundness of approach to the problems which arise in connection with the Bank's lending operations. I have found the two years which I have spent at the Bank a heartening experience in the field of international cooperation and I can assure you that the Executive Directors and the administrative staff of the Bank are fully conscious of their great responsibilities both to its members and to those who invest in its securities. I am satisfied that the administration of the Bank is efficient and entirely capable of discharging those responsibilities.

To date the Bank has made or is committed to make loans in the amount of about $650,000,000. In the spring and summer of 1947 it made a series of four European loans, to France, the Netherlands, Denmark and Luxembourg, aggregating $497,000,000. These loans came at a time, prior to the inauguration of the European Recovery Program, when European resources of dollar exchange had fallen to dangerously low levels and credits from the United States and other sources had largely been exhausted. By assisting the borrowing countries in sustaining for a period the necessary volume of essential imports, the Bank's loans helped to prevent a disastrous drop in production -- if not economic and political chaos. Among other things the proceeds of the loans were used to purchase steel mill equipment, railroad and merchant marine equipment, commercial aviation equipment, tractors, river barges, agricultural equipment, machine tools, textile machinery, chemicals and cotton, coal and fuel oil for industrial use.

Since 1947 the Bank has concentrated its activities largely in the development field, a field which is likely to absorb progressively more attention from the Bank. To date the Bank has made loans in this field aggregating about $150,000,000 to assist in financing the development of hydroelectric power and agricultural production in Chile, the purchase of cargo vessels by four Netherlands shipping companies, the development of electric power in Mexico, the expansion of hydro-electric power facilities and telephone installations in Brazil, and the installation of steel rolling and blooming mills and an electric power plant in Belgium.

Progress in the development field is necessarily slow. It takes a great deal of time and work to bring a development project to the point where it is ready for financing. Furthermore there is a limit to the speed with which the less developed countries can effectively absorb new capital for development purposes.

The progress of the Bank cannot be measured solely by the amount of the loans which it has made. A great deal of progress has also been made in assisting countries to prepare projects for financing.

The Bank now has under consideration projects in more than 21 member countries. These projects include power development, the development of transportation and communication facilities, irrigation, reclamation and other agricultural projects, shipbuilding, migration programs and industrial and mining development. Many member countries of the Bank are eager to develop their economic resources, but they often lack the technical personnel and knowledge to formulate well-planned and economically feasible programs of development. They need technical assistance, as much as they need financial assistance. They are coming more and more, therefore, to look to the Bank for help in determining what projects they should put forward for financing, in mapping out an appropriate over-all pattern for their economic growth and in formulating the economic and fiscal measures necessary to put their economies on a stronger and more stable basis. This imposes a heavy responsibility on the staff of the Bank, but it is one which I believe we must assume if we want to assure that our funds are wisely invested in practical, productive projects.

Not only is the Bank called upon to play an increasingly important role in the selection and preparation of development projects for financing, but under its Articles of Agreement it exercises careful supervision over the use of the proceeds of its loans. The borrower is permitted to withdraw funds only to meet expenses for the purposes of the loan and must satisfy the Bank that the funds will be used only for those purposes. To that end the Bank requires the borrower to submit documentary evidence of payment, delivery and shipment. The Bank also checks on the use of the equipment and materials purchased with the proceeds of its loans in order to see that they are effectively used in the project for which the loan was made. In addition, it is the policy of the Bank to maintain close relations with its borrowers and to consult with them whenever problems arise which may affect the purposes for which the loan was granted. In other words, the Bank is exercising great care to avoid the mistakes which often attended international lending in the past.

The Bank is more than a lending institution. As a co-operative international organization, its only purpose is to help its member countries to reconstruct and develop their economies along sound lines with sound financing, by providing technical assistance and advice and stimulating the resumption of private international investment. The Bank's member nations know that our insistence upon practical, productive projects and upon the adoption of sound economic policies derives solely from our desire to assist them and not from any desire to exploit their resources. They accept our advice, because they recognize it to be objective, non-political and without selfish motivation. Indeed, it is this characteristic of the Bank, as much as any other, which in my judgment gives the Bank its unique opportunity to be of service.

Now I shall briefly explain why it is so important for the Bank to maintain a broad market for its bonds. Only a small part of the subscribed capital of the Bank can be used by it in the making of loans. 2% of the capital is paid in gold or United States dollars and 18% is paid in the local currencies of the members and can be used in the making of loans only with their approval. The remaining 80% of the subscribed capital of the Bank cannot be used in the making of loans, but can only be called when needed to meet obligations of the Bank on its borrowings or guarantees. That means that, down to date, the Bank has had available out of its capital for use in the making of loans only about $745,000,000 in dollars or other currencies.

It also means that in the future the Bank will have to look more and more to the investment markets for funds with which to conduct its lending operations.

In July, 1947, the Bank sold in the United States $150,000,000 of Twenty-Five Year 3% Bonds and $100,000,000 of Ten Year 2¼% Bonds. Those bonds were sold through over 1700 securities dealers in 43 states of the United States. The bonds are listed on the New York Stock Exchange and have made an excellent record in the face of the adverse market conditions which have prevailed during a large part of the past two years. The 3% Bonds are now selling above par and the 2¼% Bonds are selling at par.

The Bank has also sold to the Bank for International Settlements the equivalent of $4,000,000 in Swiss franc bonds and has resold with its guarantee to banks and institutional investors in the United States $28,000,000 of bonds and notes which the Bank received for loans made by it to four Dutch shipping companies and to the Belgian Government.

Bonds issued by the Bank and its contingent liability on securities guaranteed by it are general obligations of the Bank backed by its entire resources. These include, in addition to its liquid assets in cash and marketable securities, a special reserve fund into which is paid the commission of 1% per year which is charged on all loans made or guaranteed by the Bank and, if those resources are not sufficient to meet the Bank's obligations, it can call on the 80% of the capital subscriptions of its members, which is subject to call only for that purpose. That 80% now aggregates $6,678,800,000, of which

$2,540,000,000 is an obligation of the United States Government.

The Bank is essentially a cooperative and not a profit-making institution. Nonetheless it is important to the credit standing of the Bank that its operations shall not be conducted at a loss. In that respect the record of the Bank has been creditable. As of March 31, 1949, in addition to over $6,700,000 held in its special reserve, the Bank showed a surplus from operations of over $10,400,000. While the margin of profit will necessarily be narrower as the Bank uses more and more borrowed funds in its lending operations, the record is such as to justify the expectation that the Bank can continue to build a satisfactory surplus from its operations.

I shall now speak briefly of the bill. As I have indicated, the capital structure of the Bank is such that it must rely for a large part of the funds that it will need for its lending operations on the private investment markets. That I regard as a virtue, because it means that, in its lending operations, the Bank must pay due regard to the soundness of its loans and must be prepared from time to time to test its credit in the money markets of the world.

For the time being, at least, the Bank must seek most of its loanable funds in the United States market. It is, therefore, important that the market for the Bank's bonds in the United States should be as broad as possible. The bill is intended to enable the Bank to broaden the market for its bonds and to facilitate the Bank's access to that market. In a sense it is only one part of a broad program to expand the market for the Bank's securities.

When the Bank commenced operations in June, 1946, statutory and administrative regulations in many states governing investment by commercial banks, savings banks, insurance companies and fiduciaries did not permit them to invest in the Bank's bonds. Since then the Bank has succeeded in obtaining legislation or administrative rulings in many states under which the Bank's bonds are legal for investment by those classes of investors. At the present time the Bank's bonds are legal for investment by commercial banks in 44 states and the District of Columbia, for savings banks in 27 states and the District of Columbia, for insurance companies in 35 states and for trust funds in 31 states and the District of Columbia. Under a ruling of the Comptroller of the Currency national banks can purchase the Bank's bonds up to 10% of their capital and surplus, and the bonds are eligible as security for United States Government deposits.

Under the National Bank Act, however, national banks are not permitted to deal in the Bank's bonds, although they are permitted to deal in United States Government bonds and bonds of states and municipalities and other public agencies. The bill would amend the National Bank Act so as to permit national banks and state member banks of the Federal Reserve System to deal in the bonds of the International Bank. That would not only broaden the market for the initial distribution of bonds by the Bank but it would also be of benefit to investors in the Bank's bonds because it would enable national banks and other member banks of the Federal Reserve System to maintain the market in the bonds, which would be a stabilizing influence on the market for the bonds.

At the present time the market for the Bank's bonds is very narrow and any substantial offering of or bid for the bonds results in substantial fluctuations in prices. If the national banks and other member banks of the Federal Reserve System could take a position in the Bank's bonds it would broaden their market and tend to diminish the extent of the fluctuations in their prices.

Moreover, there are two general categories of bonds which are dealt in on the American market. One category includes United States Government, state and municipal bonds, which are exempt from the Securities Acts, except for the fraud provisions, and which are dealt in primarily by banks and dealers who specialize in those securities. The other category includes bonds of private corporations, which are not exempt from the Securities Acts and which are dealt in primarily by dealers who do not specialize in Government bonds. The Bank's bonds are more akin to bonds of the first category and at the present time they are dealt in primarily by dealers who specialize in bonds of that category. The Bank believes, therefore, that its bonds should be given the same exemptions from the Securities Acts that are given to United States Government, state and municipal bonds.

The natural market for the Bank's bonds is the same as the market for government and municipal bonds. At the present time the Bank is handicapped in distributing its bonds in that market both because the banks cannot deal in the Bank's bonds and because dealers in government and municipal bonds are not accustomed to deal in securities which are subject to the Securities Acts and are, therefore, reluctant to deal in the Bank's bonds for their own account.

This bill would remove that handicap without impairing the protection of investors. Under the Articles of Agreement of the Bank and the Bretton Woods Agreements Act the Bank cannot sell securities in the United States without the approval of the National Advisory Council. The United States representative on the Board of Executive Directors of the Bank keeps the Council informed of its operations. If at any time the Council considers that the sale of securities by the Bank in the United States would be contrary to the public interest or the interests of American investors, it can refuse to approve the sale.

The Securities and Exchange Commission has an observer on the National Advisory Council who is also a member of the staff of the Council. The Commission is thus kept informed of any applications by the Bank for approval of the sale of its securities in the United States and the Commission can through its observer consult with and advise the National Advisory Council on all such applications.

Under the bill the Securities and Exchange Commission could require the Bank to file with the Commission such annual and other reports with regard to securities issued or guaranteed by the Bank as the Commission deemed appropriate and necessary in the public interest or the interest of investors. The Commission can thus be fully informed with regard to sales of securities by the Bank and, if the Commission should have reason to believe that the sale of securities by the Bank would be contrary to the public interest or the interests of investors, it could, if it found it necessary to do so after consulting the Bank and the National Advisory Council, exercise the power given to it under Section 3 of the bill to suspend the exemption of the Bank's securities from the Securities Acts. Thus the Securities and Exchange Commission would still have ample power to require a full disclosure of the facts in connection with any sale of the Bank's securities in the United States and to prevent any abuse of the exemptions by the Bank.

Last but not least, the Bank is an international institution having on its Board of Executive Directors representatives of its 48 member governments. It is not an institution organized for private profit and its international character requires that it give the fullest practicable publicity to its operations. This it does through annual and quarterly financial reports and releases to the press. The record of the Bank's operations in the past three years is adequate assurance that investors in its securities will receive full and accurate information as to its financial condition and its operations. Any other assumption would be unrealistic in the extreme. And should there be in the future any adverse change in the policies of the Bank in that regard the Securities and Exchange Commission could suspend the exemptions granted by the proposed legislation.

As the Committee knows, I have resigned the presidency of the Bank to take effect on or before July 1 and Mr. Eugene Black has been appointed to succeed me. He has been the United States Executive Director of the Bank for the past two years and during that period has advised the Bank in connection with the sale of its securities. I am confident that under his leadership the Bank will continue the progress which it has made in the past two years and that its policies and practices in selling securities will be sound and in the best interests of the United States and of investors. I sincerely hope that the Congress will see fit to assist Mr. Black in the important task which lies before him by passing this bill.

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