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Epitaph for Bretton Woods

Economic evolution following World Wars I and II was determined mainly by the inter-allied financial agreements that settled their armaments and reconstruction debts to the United States. The reaching of these financial agreements shifted the arena of conflict from the battlefield to the diplomatic meeting rooms. What had been a contest between allied and axis nations gave way to one fought amongst the allies themselves, from which the United States emerged victorious.

Allied self-interest at Versailles was unenlightened in that it burdened Germany with an unrealistically heavy reparations schedule. It was America's insistence that these allies fully honor their war debts (a request unprecedented in European historical experience) that firmly imposed upon them the need to insist that Germany maintain its reparations payments. According to U. S. financial strategy German reparations were to provide the allies with funds to service their debt to the United States, which in turn found itself obliged to extend new loans to Germany to keep this flow of reparations intact. A triangular flow was thus set in motion, with funds flowing from the United States to Germany in the form of stabilization loans, from Germany to the allies in the form of reparations, and from the allies to the United States in the form of debt service and net imports of American merchandise. Finally in 1931 this triangular flow of international payments broke down, and although reparations and inter-allied debts were suspended, the world entered an era of economic and monetary nationalism that was to culminate in World War II.

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In the closing days of this second war, the allies' self-interest was considerably more enlightened. They did not intend to burden the axis powers with major reparations payments. The problem facing U. S. diplomats at Bretton Woods in 1944 was how America's allies were to honor their new indebtedness to her. Their enlightenment was reflected in the fact that they did not leave America's allies without an institution capable of financing their wartime and postwar debts, but took the lead in forming the International Monetary Fund and the World Bank to supplant Germany as the mechanism to provide the allies with means—to be borrowed at the cost of further indebtedness to the United States in the form of "dollar drawings"—to service their growing international debt to the United States and to sustain their demand for U. S. exports, and throughout, to maintain the gold in the vaults of Fort Knox as the fulcrum of world economic power. It was not the treaties with Germany, Italy and Japan that shaped the post-war economic evolution, but the Bretton Woods agreements and the General Agreements on Tariffs and Trade (GATT).

Through the mechanism of the IMF the United States firmly grounded the power-system of international finance upon the buttress of its gold. Through the World Bank it helped finance a division of the world along the dictates of "comparative advantage" into an industrial North America and Europe on the one hand, and a less advanced, raw-materials producing group of countries elsewhere. The movement towards free-trade signaled by GATT worked to reduce further what barriers against "comparative advantage" had been erected by the less industrialized and agriculturally backward countries in an attempt to shape their own economic evolution.

The trends fostered directly and indirectly by the operations of these two institutions since their inception can no longer be sustained. In the realm of economic development, the backward countries have failed to transform their agricultural sectors into a basis for achieving balanced industrial growth. The result has been domestic inflation, a rural exodus, a growing food deficit, and a financial deterioration both on the domestic and international fronts. Meanwhile, in the realm of international finance the more developed nations are beset by an impending break in the chain of payments threatening to result from the chronic balance of payments deficits of the United States and Britain. It is the thesis of this essay that these problems have been aggravated by World Bank and IMF operations, and promise to be further aggravated under the current proposals for their modification.

Within the IMF the activation of "Special Drawing Rights" (SDR's) has been proposed in the "deficit axis" led by the United States and Great Britain in the belief that what is needed is more international liquidity, not less. Admittedly the IMF's resources no longer suffice to meet today's international financial dislocations. However, it is by no means clear that these dislocations *should* be financed. What the SDR proposals represent is an attempt to transform the IMF from an organization designed to finance temporary cyclical balance-of-payments fluctuations into one designed to finance permanent deficits by a "dollar block" comprising the United States, Britain, Canada and Latin America. Technically, this proposal represents a return to Keynes' 1943 draft for an "international clearing union" which was controverted at the time by U. S. representatives to Bretton Woods on essentially the same grounds that European countries are opposing it today, namely, that the solution to international financial dislocations does not lie in the enactment of special credits for the chronic deficit countries and that activation of such credit on any substantial scale would serve to aggravate world inflationary pressures. What the Common Market nations are asserting is simply that the deficit countries must adjust their economic and military policies to the constraints of international finance rather than calling, as the United States is doing today and as Britain attempted to do in 1943-44, for the rest of the world to adjust *its* economic evolution to the dictates of a deficit axis.

The World Bank, meanwhile, finds itself "loaned up": further debt cannot be serviced by the backward countries without miring them even more deeply in the disadvantageous position of having continually to refinance their outstanding indebtedness to foreign central banks on economic and political conditions laid down by these banks. This has already led to a return to the quasi-political bilateralism which played such an undesirable role in international finance prior to 1945, and which the Fund and Bank were originally designed to end. The essential problem of World Bank lending goes further, however: the beneficial effects that have been conveyed to the backward countries by past loans have been largely offset by the "dual economy" which they have fostered. An economically sophisticated export sector has been created which is more a part of the advanced nations' economies than those of the backward countries themselves, and which has been partially responsible for the rural exodus that is burdening these countries' urban and educational resources. Another result has been a food deficit that has offset the export surplus accruing from increased raw materials output. All of Chile's increase in foreign exchange receipts deriving from expanded copper production since 1952, for instance, has been offset by increased food imports. Unfortunately, current World Bank proposals to solve this food problem by transplanting sophisticated capital-intensive food technology and by population control programs attack only the symptom rather than the underlying cause which is structural backwardness. In this respect the Bank's new loan philosophy has been put forth not as a supplement but as an *alternative* to agricultural modernization: it seeks merely to enable these countries to minimize temporarily the inexorable conflict between growing food needs on the one hand and outmoded systems of land tenure and associated agricultural practices on the other.

I

The IMF and the World Bank were conceived during 1941-1945 as the product of joint U. S. and British diplomatic designs for the postwar world. Their articles of agreement were drawn up in the closing days of World War II mainly to meet Europe's immediate postwar reconstruction needs by avoiding those financial problems which had plagued the interwar period, in particular monetary warfare and protectionist policies. During the quarter century that has elapsed since that time, their operating philosophy has fundamentally altered in response to the evolution of the U. S. balance of payments from a position of unsustainable surplus to unsustainable deficit. As this evolution has occurred, a divergence of interests has developed between the United States and Britain on the one hand, and Europe and the backward countries on the other. Because voting power in the fund and bank is dominated by the Anglo-Saxon nations, these other countries find themselves unwillingly drawn into an economic position which they recognize to be undesirable: having to finance the U. S.-British deficit with their own resources, under penalty of international financial crisis should they cease to do so.

The shift in U. S. self-interest which has underlain the change of operating philosophy within the IMF and World Bank may be highlighted by comparison with that of Britain during 1941-1945. Then as now, Britain found her self-interest to be that of the world's major debtor on short-term capital account, and the major deficit-nation on current account. In fact, her position was somewhat akin to that of Germany at the end of World War I, with an analogy to German reparations lying in her unmanageably high level of sterling balances and war debts, and her prospective deficit on military and trade account.

Britain's nearly $10 billion in sterling balances (due mainly to India, Egypt and Argentina) were effectively frozen because she could not provide an economic net equivalent to export production. Nor did much prospect exist for her to amortize her longer-term war debts (due mainly to the United States) out of a current account surplus, inasmuch as her desire to maintain the full military trappings of world empire threatened to drain her systematically of what net international receipts her private sector might generate. Thus, for her foreign debt to be amortized and for the military costs of her fading empire to be maintained, some external source of funding must be found.

In the face of this unmanageable short-term debtor position and her chronic deficit on current account, Britain's representatives to Bretton Woods were concerned mainly with a futile search to reconcile domestic autonomy to pursue expansionary postwar employment policies with the inevitable financial constraints imposed on her tenuous financial position, a position which she was as reluctant to give up as she was her military empire. It was her position as international banker that had made her the repository for a massive inflow of short term funds, which she effectively used to reinvest abroad at correspondingly higher rates of return. That she did not wish to suffer the "constraint" of having to liquidate these long-term investments to satisfy her short-term creditors at times when they wished to withdraw their cash is understandable. Nor did England wish to impose deflationary policies on her citizens as an alternative to appropriating and selling off the foreign long-term investments of her private sector. Quite simply, England wished to continue to enjoy the benefit of being a banker (namely, that of receiving deposits) without suffering the constraints (having to return these deposits to their owners on demand, even when this called for liquidating long-term investments). It was this condition which led the British proponents of Bretton Woods to represent Britain's dilemma as one of either satisfying her creditors or imposing domestic austerity, omitting all reference to liquidating Britain's international position. "We are determined," announced Keynes to Britain's House of Lords on May 23, 1944, "that in the future the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way around." What this meant in practice was that foreign countries (at least those of the sterling area) should adjust *their* economic policies to meet those of deficit Britain. "A proper share of responsibility for maintaining equilibrium in the balance of payments," Keynes continued, "is squarely placed on the creditor countries" by the IMF's article of agreement, specifically the "Scarce Currency Clause" (Article VII). In its original formulation this clause had called for chronic surplus nations such as the United States to let their credit balances accumulate indefinitely with the proposed clearing union until, at the point where these balances became unmanageably high, they might be cancelled altogether or the deficit countries in some other way freed from their obligation to pay for their current purchases from the surplus nations.

In view of its "permanent" payments deficit, Britain wished to make massive drawings from the planned International Monetary Fund without incurring indebtedness to specific countries. The United States, however, insisted that since drawings would in effect be made at the cost of individual countries, they should be denominated in the actual currencies drawn rather than some nebulous "bancor" or "unitas" credit, and that the dollar be made available to foreign countries only up to the limit of the U. S. subscription-tranche. "It was never reasonable," observed John H. Williams of the New York Federal Reserve Bank, "to suppose that the United States could assent to a scheme under which its liability, in the event of a concentration of world demand upon the dollar, would be limited only by the aggregate size of the clearing union."[1] The U. S. representatives to Bretton Woods therefore insisted on a "fund" rather than a "bank," a pool of national currencies rather than a blanket overdraft facility.

These representatives were concerned not with avoiding the rigors of "stabilization" which so troubled Britain, but with the problem of how to foster postwar trade and still maintain gold as the basis of international finance. They presented the IMF and World Bank to Congress essentially on the ground that it was necessary to provide Europe with the resources to purchase U. S. exports if full employment were to be achieved in the United States.[2] In this sense the Bretton Woods Act was

[1] John H. Williams, *Postwar Monetary Plans and Other Essays.* (New York: 1944), p. xvi. Professor Williams provided a succinct contrast between the American (White) and British (Keynes) plans of 1943: "The White plan provides for an international stabilization fund. The member countries would deposit their currencies with the fund, which would then undertake to provide the currencies needed by each country for settling its international account. The Keynes plan provides for an international clearing union in which no funds are deposited. Instead, international payment would be effected by debiting the paying country and crediting the receiving country on the books of the union." The difference, in short, was that between the U. S. bank deposit principle and the British "overdraft" practice. By the latter, "the clearing union would engage in no exchange operations itself, but merely keep books." (*Ibid.*, p. 7.) The manner in which the current SDR plan harkens back to Keynes' proposals is apparent.

[2] This position was perhaps best represented in Assistant Secretary of State Dean Acheson's congressional testimony that:

a necessary complement to the Full Employment Act of 1945. Some $10 billion in annual U. S. exports was held necessary to assure full domestic employment. In the words of one expert, "I think what we put into the fund will represent for all practical purposes an export subsidy."[3] Without the financial resources of the Bretton Woods institutions, it was perceived, the United States would find itself obliged to supply these exports to Europe in the form of outright grants. "We want our exports to increase," testified Under Secretary of the Treasury Harry Dexter White, "but we want other countries to be in a position to pay."[4]

Not only did full employment in the United States presuppose a high level of foreign purchasing power to buy U. S. exports on commercial terms, but it required free trade policies among its trading partners. The Bretton Woods meetings, therefore, set the condition that signatories of the IMF articles of agreement must agree not to enter into bilateral monetary agreements or other forms of blocism, save for the sterling area, which was left intact. The foundations for what was to become the General Agreement on Tariffs and Trade (GATT) were thus laid. In the words of Secretary of the Treasury Henry Morgenthau, who acted as chairman of the U. S. delegation to Bretton Woods, "Because it offers a method for stabilizing currencies, the monetary fund... removes the excuse for the tangle of import quotas, discriminatory tariffs and other disparate measures which added so many difficulties to the friendly economic relations between nations in the thirties."[5]

Supplying Europe with credit to purchase U. S. exports paid the political dividend of enabling the continent to reconstruct its economies within the context of political stability. "Unless something is done," one expert testified, "it is my belief that you are going to have a continuing chaotic condition in those countries and that they will inevitably go on

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"We have the greatest productive plant in the world. While the rest of the world has been undergoing destruction we have been building up this plant in order to carry the great burden of the war.

"One of the problems in the future will be to keep that great plant employed and to keep the people employed who are now working in it or who come back from the armed forces.

"Very well. We all profit by enabling these countries which have been destroyed, or which need development, to make purchases from those who can produce the goods they need." (Senate Committee on Banking and Currency, *Hearings on H. R. 3314* (hereafter referred to simply as *Senate Hearings*) p. 40. See also the testimony of Morgenthau (pp. 5-7) and Clayton (*House Hearings*, pp. 275, 282).

[3] Testimony of Imrie De Vegh, *Senate Hearings*, p. 357.

[4] *Ibid.*, p. 164.

[5] *Ibid.*, p. 6. See also p. 11, as well as the *House Hearings*, pp. 29, 33, 290. Britain, of course, also found her interest to lie in free trade.

to some form of totalitarian government, simply because it will be the only way that their people can get food to eat. And I think that if such a thing happened apart from the destruction of any possibility of increase in foreign trade it would increase military and naval expenditures on the part of the United States that would cost us far more than any possible risk that is involved in our contribution to the fund.... chaotic economic conditions in a country produce civil wars and civil wars are apt to produce wars between nations." Senator Millikin paraphrased this thought to read that, "as you have an increase in totalitarianism our own military risks increase; therefore, we have to spend more for armament, and so forth." Without currency stabilization, the expert responded, "you won't have any great volume of foreign trade, and you will have very heavily increased military expenditures."[6] In this respect the U. S. subscription to the IMF represented a disguised military subsidy designed to dampen the prospects of hyperinflation and the related economic dislocations that had so disturbed European politics in the 1920's.[7]

The financial resources provided by the Bretton Woods institutions also enabled Europe to service its war debt to the United States. In the absence of such resources a moratorium on this debt would have been in order, just as the rigors of the gold exchange standard had in the 1930's led to a suspension of the Inter-Allied debts. By providing Europe with means to continue its debt service payments, the United States retained its creditor-hold on the continent.

Perhaps the most basic advantage of Bretton Woods to the United States was that by providing international financial resources to *supplement* Europe's depleted gold reserves it enabled gold to be maintained as the basis of international finance, rather than a managed paper or commodity standard. In 1945 the United States held some 59 percent of world gold reserves and was to increase its share to 72 per cent by 1948. "Unless that gold can be used as the foundation for international trade," observed Senator Downey, "it really has no actual value at all, more than its value for commerce. In putting up a few billions of gold in this great enterprise we are merely attempting to salvage the value of

[6] Testimony of Edward Brown, Chairman of the Board of the First National Bank, Chicago, *Senate Hearings,* pp. 104-05.

[7] Somewhat related to this consideration was the fact that the IMF's resources made possible the continuation of Britain's overseas military expenditures, something which has obscured that country's search for domestic autonomy throughout the postwar period, and has ultimately necessitated the continued sacrifice of Britain's domestic autonomy to the balance-of-payments constraints imposed by its overseas military budget. On this point see De Vegh's testimony in the *House Hearings,* pp. 944-45, 952.

that gold itself . . . that gold just isn't worth anything unless it becomes the foundation of international trade."[8] The U. S. authorities acknowledged that a maldistribution of gold had occurred during the 1930's and the wartime years and that an inordinate portion had become concentrated in the United States. Their first desire, however, was to maintain the economic and diplomatic power embodied in this gold—to retain it as the basis of international finance and to lay the foundation of postwar economic evolution upon it, while at the same time moving towards freer trade policies which could not otherwise have been sustained under international gold holdings as they were then distributed. The resources of the IMF and World Bank thus enabled the essential rigors of the gold standard to be preserved, and with it free trade, investment, and continued American financial hegemony.

The United States understandably wished domestic economic autonomy just as did Britain. Towards this end the IMF and the World Bank were organized along the lines of private stock corporations, with the U. S. capital subscription of just under $3 billion entitling it to 27 per cent of the voting power in the two institutions (a share which would rise to a maximum of 33 percent as its currency was drawn down). Because an 80 per cent majority vote was required for most rulings, the United States thus maintained *unique* veto power in the two organizations. (The British empire taken as a whole controlled about 25 per cent of the voting power.)

Being the world's major creditor and current account surplus power, the United States also understandably wished to detooth the "Scarce Currency Clause" which Britain had taken so seriously to heart. At its insistence the clause was rewritten so that chronically surplus countries were obligated merely to *listen* to IMF recommendations, not to act upon them. Today, of course, the United States has come to espouse the economic philosophy of urging surplus nations to adjust their policies to those of deficit countries, specifically in its request that European countries "finance" the U. S. Treasury securities, the pursuit of expansionary policies in the payments-surplus countries to "match" those of the United States, and revaluation of strong currencies such as the German mark. In view of this current position on the mutual responsibility of debtor and creditor countries, Mr. White's 1945 testimony on the subject is illuminating:

> In some of the proposals that were submitted by experts of foreign countries they wanted to impose a penalty on the country whose cur-

[8] *Senate Hearings*, p. 37.

rency became scarce, having in mind, of course, chiefly the United States. . . .

The American technicians took this position: We would not consider any such penalty and we would not accept such a conclusion. The causes for countries buying more than they are selling differ from time to time and from country to country, and the chief fault may not at all be ours. It might be ours in part, but it might also be the fault of the other countries. The mere fact that a particular country wants to sell us fish oil although we don't want to buy it, perhaps we don't like so much fish oil, is no reason why they should force us to buy more fish oil. In other words, countries may be living beyond their means. They may think there is an unlimited amount of foreign goods they can buy from the United States irrespective of what they can sell. What they have to sell may not be sufficiently desirable to other countries.

Countries may get into a position where there is a scarcity of foreign currency not because of the fault of the country from which they are buying but due to their own extravagant policies. We said we could accept no such assumption, either implicit or explicit, that if dollars become scarce in the fund, that the fault is necessarily ours. We finally agreed that if any currency becomes scarce a report will be prepared and a member of the committee which prepares that report shall be a representative of the country whose currency is becoming scarce. We want to make certain any report made is a competent one, and places the responsibility for the scarcity where it belongs and gives proper weight to each of the various causes. We said we would agree to have the fund make a report. More than that if the fund declares a currency scarce we would agree that the fund be required to make public the report. That, we think, is highly desirable, because if there are causes for that scarcity which are in part due to politics pursued by the United States, then we think that Congress ought to know it. The report of the fund would have prestige, if the fund earns prestige. If the fund conducts itself in such a way that it wins the confidence of the various countries, Congress or a committee—your committee would have it—would have before it the report of the fund for you to examine for what it was worth. If the reason stated in the report seemed sound it might influence your policy, you would take that fact into consideration. You are not required to do anything about it. All that you are called upon to do is to give the report of the fund consideration.

. . . The only thing that the fund can do—and we were quite agreeable to include that, and I think it is an excellent thing—is to make a report. . . . If you thought the arguments that were given were sound and that they did indicate and called for some modification of Government policy, I am sure you would be glad to adopt it. If, on the other hand, you felt that they were in error, if you felt they were distorting the facts, I am sure you would likewise give the report the consideration which it deserves. You would in that case throw it in the basket.[9]

These then were the U. S. objectives: to increase its exports by extending dollar loans through the IMF and World Bank and by establishing a worldwide trend towards free trade policy; to curtail potential political dislocations in Europe; to maintain gold as the basis of postwar financial power; and to retain full domestic autonomy to follow those policies it desired, while holding veto power over whatever possible actions the IMF member nations might propose. These objectives it obtained in exchange for a capital subscription of some $3 billion.

Its self-interest in seeking these ends was enlightened to the extent that it corresponded with that of Europe—so far as it went. Europe was provided with resources that it would not otherwise have possessed, while not giving any direct financial *quid pro quo*. The limits of U. S. enlightenment were defined by the directions in which it did *not* push the Fund and Bank: as documents of political economic diplomacy, the articles of agreement which established the World Bank and IMF must be viewed as alternatives to other resolutions of the international financial strains that then existed.

America's postwar plans, for instance, did not absolve Europe of its war debt (even that of World War I, although many experts advocated this), an action that would have freed some $300 million annually for Europe to expend on real goods and services. Indeed, as observed above, by providing the resources for Europe to meet its debt service the Bretton Woods institutions enabled the continent's debt to be retained on the books.

Nor did the agreements work to redistribute the world's gold stock. In fact, they served to concentrate more gold in the United States throughout the remainder of the 1940's. America's strategy of post-war economic development called for Europe to add some of the newly-mined gold to its reserve and hopefully to obtain a substantial portion of the gold balances built up by the South American republics during the war, but not from the United States. In this respect the less developed countries were to be sacrificed for the benefit of Europe:

Service charges on loans have to be transferred by the new debtors [i.e. the European countries] primarily through increased exports of

[9] *Ibid.*, pp. 168-70. See also Professor Williams' testimony on p. 322, and that of Mr. Clayton in the *House Hearings*, p. 278.

manufactured goods or through the rendering of services, such as shipping or tourist services. Exports of these goods and services direct to the creditor countries, particularly the United States, may not be sufficient to meet all the debt obligations in addition to making payments for current transactions. It is necessary that these debtor countries have an export surplus on current account with the countries producing and exporting primary products, and that the United States and all other creditor countries which supply most of their requirements for manufactured products from domestic production have an equivalent import surplus from the countries producing primary materials.[10]

In the realm of international finance the Bretton Woods institutions did not succeed in providing multi-lateralism. Originally they had been held up as an alternative to the "key currency" standard advocated by Professor Williams and others, which was in effect a "dollar standard" tying the rest of the world into a dollar bloc. On this point August Maffry, a division chief of the Bureau of Commerce, observed that:

> The key-currency approach as set forth by its principal advocates, envisages an initial agreement between the United States and the United Kingdom on the sterling-dollar rate. Other currencies would be linked to either the dollar or the pound. There would be consultation and collaboration between the United States and the United Kingdom and other major financial powers and between such powers and their respective satellites. This approach is frequently accompanied by a proposal for a loan or gift of large amount (say $5,000,000,000) by the United States to the United Kingdom and similar aid to other countries requiring it, as a means of assisting them in liquidating debts incurred during the war and in rehabilitating their international positions generally. For strictly stabilization purposes, however, a relatively small revolving fund of perhaps a few hundred millions of dollars would be considered adequate by its proponents.
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> Now, there are many common elements in this approach to the problem of currency stabilization and the approach embodied in the pro-

[10] U. S. Department of Commerce, *U. S. International Transactions during the War: 1940-45* (Washington, D. C.: 1948) pp. 160-61. In the words of one interested congressional witness, "We can keep triangular trade alive and promote its further growth. This kind of trade is important to us because it lets us sell to Europe hundreds of millions of dollars worth of goods more than we buy from Europe—and most of these sales are normally agricultural products, including wheat, pork, lard, etc., from our Northwest. This is possible because we buy from countries other than Europe hundreds of millions of dollars worth of goods more than we sell to them; we buy goods we need for our economy, particularly the world's great noncompetitive raw materials. It is through these purchases that our dollars are made available for these other countries to buy from Europe, so providing Europe with the dollars necessary to pay for our agricultural exports." (Testimony of Henry A. Bullis, *House Hearings*, p. 497.)

> posed Monetary Fund. The fixing of the dollar-sterling rate would be a prerequisite under either approach to the establishment of a general system of exchange rates. Both would give chief responsibility and authority to the major powers. Both provide for stabilization credits, and both are conditioned upon a substantial reduction of trade barriers generally and upon sound internal financial and economic policies. Indeed, it is a fair guess that a full development of the key-currency approach would result in a plan not dissimilar to the Monetary Fund proposal.
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> There are, however, crucial differences between the proposed Monetary Fund and the key-currency scheme in its present stage of development. *Smaller nations have an important voice in the fund which would be denied them under arrangements between key currencies only. The multilateral provisions of the fund plan discourage, while the other approach would seem to encourage, the perpetuation and formation of economic blocs, with all of the trade preferences and restrictive bilateral deals which go with them.*[11]

In fact, this economic blocism has materialized since 1952: in a situation where fund and bank resources were inadequate to meet the banking needs of international finance (not being designed to be loaned to the private sector, but rather to the government sectors), the U. S. dollar has filled the breach. By providing dollars to the world through the mechanism of its deficits, the United States has enabled itself to obtain consistently foreign resources solely on the basis of its printing presses rather than by parting with its own resources. In this sense any "key currency" enjoys a privileged position. It has been the institutional limits of the IMF that have enabled this situation to come about. As a result, the Bretton Woods institutions became virtually the Anglo-American "key currency" system with the surface trappings of multilateralism.

Perhaps the greatest shortcoming of U. S. self-interest was its desire to maintain the international division of labor as it then existed—particularly its desire to find export markets for its agricultural surpluses in

[11] August Maffry, "Bretton Woods–and Foreign Trade," *Foreign Commerce Weekly*, October 7, 1944 [quoted in *House Hearings*, p. 313 (italics added)]. In the words of one reporter, "The difference between the key currency approach and that of Bretton Woods might be illustrated by observing the difference, in the political sphere, between an Anglo-American alliance and the wider plan for world security drafted at San Francisco. The key currency plan is a plan for a currency alliance. It would not be an exclusive one, to be sure, since other nations would be encouraged to tie their currencies to the standard set up by Anglo-American cooperation. But it would mean that other countries, to get into the alliance, would have to meet Anglo-American terms." (Carlyle Morgan, *Bretton Woods: Clues to a Monetary Mystery* [Boston: 1945] p. 78.)

just those agriculturally backward countries which were most in need of agricultural modernization. The Latin American countries, to be sure, had succeeded in changing the Bank's title to the "International Bank for Reconstruction *and Development*." (They had asked that its resources be divided half-and-half between reconstruction and development aims, but were overruled on this by joint American and European opposition.) What was most needed by these countries was the foundation of industrial growth upon the basis of an agricultural revolution.[12] Nonetheless, what discussion of agricultural problems did transpire in the U. S. congressional hearings dealt entirely with the beneficial effect on U. S. farm exports to be derived from World Bank and IMF lending activities.[13] Assistant Secretary of State W. L. Clayton observed that the World Bank lending program "would certainly be a very good one for agricultural exports, because as you help develop these countries, help develop their resources, and help develop them industrially, you will shift their economy somewhat from an agricultural economy to an industrial economy, so that I think in the end you would create more markets for your agricultural products rather than otherwise."[14] In other words, industrialization of the backward countries was to be accompanied by a growing food deficit rather than building upon an increasingly productive agricultural base.

This limited philosophy of economic "growth" reflects the tragic error in development economics that has characterized World Bank loan philosophy since its inception: the view that industrialization of backward countries can be undertaken within the context of balanced growth *without* fundamentally modernizing their agricultural sectors, specifically in the direction of operator-owned farms such as have underlain America's great revolution in agricultural productivity. Rather than foreseeing, much less *planning* for increases in agricultural productivity

[12] As early as 1826 Alexander Everett, U. S. ambassador to Spain and close associate of John Quincy Adams, observed that while Latin America's revolution of the 1810's-1820's had freed it from the yoke of Spain, the inequitable forms of property ownership which nonetheless remained as a heritage from Spanish land grants would continue to retard the development of democracy there. Latin America, he concluded, could not achieve the rapid social and economic strides made by the United States until it had passed through yet another revolution which would redistribute its land and transform its institutions of property ownership. (*America* [Philadelphia: 1826] pp. 343-44.)

[13] See for instance the testimonies to the *House Hearings* by Harry A. Bullis of General Mills (p. 497), Edward O'Neal of the American Farm Bureau Federation (pp. 600-01), Russell Smith of the National Farmers Union (p. 1036), and the observations of Rep. Baldwin of Maryland (pp. 274-76).

[14] *Ibid.*, p. 276.

in those countries which so desperately needed it then and need it even more today, the assistant secretary merely observed that "if you have a country that today is devoting all of its labor and nearly all of its economic activity to the production of agricultural products for export, if you help them develop industrially, and use their labor and other things for industrial development, I think it will take something from their agricultural activities, and to some extent reduce the competition which we have in this country."[15]

What the U. S. congressional hearings reveal is, if anything, a *fear* of the backward countries underselling U. S. farmers or displacing U. S. agricultural exports rather than the hope that they might indeed increase their agricultural self-sufficiency. Because of this somewhat narrow U. S. self-interest in its lending and development philosophy, the World Bank was from the outset precluded from playing a role in the social revolution impending in the Third World.

The backward countries were to be sacrificed to Europe as their accumulated gold reserves were transferred abroad, and to the United States as they increased their purchases of U. S. farm products which, given structural agricultural modernization, they could have produced themselves. Europe desired export markets for its manufactures, while the United States desired markets for its farm surpluses. As a result, the development strategy of fostering the less developed countries' export sectors was designed to provide raw materials needed by North America and Europe in *their* industrial growth, while dismissing the plight of the backward countries as one of being forever established by the static dictates of "comparative advantage." Of all the national interests left unrequited, theirs was the largest.

Question naturally arises as to why, if these factors were recognized at the time, did Europe and the backward countries elect to join the fund and bank? The answer is to be found simply in the fact that these two organizations provided *something* in place of nothing. In the words of Leon Fraser of First National City Bank:

> We are told that 44 nations agreed to this. I think a more exact statement would be that 3 or 4 groups of very expert chaps got together and wrote a plan, and then took it up with 44 other technicians, stating that 'this is what the United States and Great Britain are willing to stand for with you.'
>
> Of course, in the condition of the world as it was at the time of those

[15] *Ibid.*, p. 286.

> negotiations, these fellows said, 'Sure, why not?' They had nothing whatever to lose. They looked to us for their military salvation and for their economic salvation, and any proposal within human reason put forward by representatives of the United States would in the nature of things be acceptable.[16]

II

Division of the world into "developed" and "undeveloped" sectors has increased during the postwar period. Not only have the backward countries failed to embark upon self-sustaining growth, but they have failed even to increase food output in keeping with their population growth: during the past ten years per capita food output in the backward countries has actually declined 2 per cent, while in the industrial nations it has increased by 11 per cent. [This discussion excludes the communist countries.] The industrial nations have thus taken a "comparative advantage" in agriculture, as testified to by the fact that since 1964 most of the growth in U. S. exports has consisted of agricultural products, while the backward countries have generally seen their food deficits increase.

Largely responsible for this unfortunate evolution has been the fact that international specialization of production during the postwar era has been permitted to evolve along the path dictated by "comparative advantage." What has not been sufficiently stressed is that, as a guide for allocating productive resources, "comparative advantage" serves to maximize resource output only at a moment of time. For a given year, for instance, a country such as Chile might find its advantage to lie in producing copper rather than industrial goods or wheat *under its existing resource productivity returns* and under the existing structure of world prices as conveyed through the mechanism of free trade, so that a given quantum of its labor may be devoted to extracting copper and exchanging this for a greater sum of food products than could be obtained with an equal employment of domestic labor in agriculture. As a policy for maximizing resource allocation *over time*, however, the doctrine of comparative advantage is invalid. Over time the economic strains brought about by Chile's specialization in mining production and by its relative neglect of agriculture have more than offset the sum of year-by-

[16] *Ibid.*, p. 408. Gen. Ayres of the American Bankers Association testified that "I fully expected that the people of the other nations would agree with whatever we agreed to, because they knew that this was going to deal with money, and we have the money and they need the money." (p. 809) See also the testimony of Professor Kemmerer (p. 869) and Melchior Paly (p. 901).

year gains dictated by its "advantageous specialization." For Chile as for most other agriculturally backward countries, the opportunity cost of having lived a year-by-year economic strategy during the last quarter century has been high indeed.[17]

As recently as fifty years ago the doctrine of comparative advantage indicated that the backward countries would continue to export food surpluses to obtain their industrial manufactures. What it failed to anticipate was that international productivity differentials continually evolve, generally at the expense of the agriculturally backward countries both in agriculture and industry.[18] As a result, the former grain exporting regions of Latin America and Southeast Asia have deteriorated to food-deficit status, and the international reserves with which they emerged from World War II have been exhausted—one is tempted to say squandered—to finance their outmoded institutions of land tenure and its related technology that represents their burdensome agricultural heritage: in Latin America a quasi-feudalistic legacy descended from the Spanish land grants, in most of Africa a collectivistic form of landownership, and in the Asian countries a heritage of microfundia interspersed with plantation export-agriculture. The result has been that the 1960's, instead of representing a "decade of development," have turned out to be a decade of regression for most of these countries.

[17] As Professor Williams noted at the time, "The English classical theory of international trade, of which the gold standard theory was the monetary counterpart, never took adequately into account the problem of economic growth. It was a theory of trade between countries of known resources, already existent and in use, and it asked only how through international trade such resources might be most effectively applied to mutual advantage. It was, in other words, a theory of maximizing national incomes here and now, and never took account of the fact that only by interfering with its processes could young countries maximize their future incomes—and by developing more buying power increase the future incomes of their customers as well. The classical theory was a rationalization of British practice and policy, universalized into economic law at a time when it suited the British national interest. Continental European economists never fully accepted it, nor did young countries in process of development ever act unreservedly upon the basis of it. I have never been able to see how in strict compliance with the classical theory the young countries could ever grow out of being colonial-type feeder countries for the advanced industrial countries." (*Op. cit.*, pp. xvii-xviii.) From the beginning Professor Williams urged that greater latitude be given to the backward countries, and demonstrated how the "pure" models of international trade and growth endorsed by the fund and bank did not apply to countries not producing the full range of industrial and agricultural goods and services (pp. xix, 141).

[18] That the effect of foreign trade on the evolution of productivity differentials among nations is fully as important as the evolution in the *terms* of trade was emphasized by the pre-Civil War American protectionists such as E. Peshine Smith, Henry Carey and their followers. It was the doctrine of these economists that underlay American economic development during the half century following the Civil War.

It is to the World Bank's credit that it attempted to move the backward countries along the path of industrial growth rather than forsaking them entirely to the workings of "comparative advantage." However, its philosophy of economic development has been one of fostering industrial growth in these countries without simultaneously renovating the agricultural base of this growth. Only eight per cent of World Bank lending through 1962 was for agricultural purposes. Because no other international organization existed to finance agricultural modernization, the effect of World Bank lending was to retard indirectly the evolution of agricultural production in the backward countries: by emphasizing the creation of an urban industrial infrastructure and an export-oriented extractive industry, its loan programs stimulated an unmanageable rural exodus of untrained migrants into the cities that has aggravated these countries' food deficits. An increasing number of urban dwellers must be fed by a diminishing number of agricultural producers and, given the failure of agricultural productivity to develop sufficiently to make up for the attrition of labor, food shortages have developed which have led to an inflation of food prices, living cost and wage rates, plus an exhaustion of international reserves to pay for increased food imports. Bank lending, instead of spurring economic growth within a "stable" institutional framework, has therefore served to destabilize the economies of its loan recipients.

The Bank does not appear to have recognized this. It continues to be limited by a narrow technological view of growth that has confused the problem of economic *advance* within an already-established growth pattern (as was experienced by Europe in its reconstruction years) with the problem of *backwardness*, which concerns the transformation of those institutions which render labor and land uneconomic under existing methods of production. Its diagnosis of the problems of backwardness is limited in scope in that its development strategy has been one of mere "resource allocation" rather than institutional *transformation*.

This strategy has been reflected in the "stabilization" programs which the Bank has recommended to loan-recipients, and which have often aggravated their instability by seeking monetary solutions to structural defects, attacking the symptoms rather than the causes of the problem at hand. Indeed, by freezing the existing institutional structures of these countries with all their irrationalities, the World Bank-IMF stabilization programs have not infrequently resulted in the downfall of the very governments that have agreed to impose these programs. (Argentina and Turkey in 1958 are cases in point.) The Bank's failure to recognize the scope of the problems to be faced in true development lending has if anything been reinforced by its initial success in European reconstruction loans to nations which did not require fundamental social restructuring.

The stabilization programs indicated the extent to which the Bank conceived of the backward countries' needs in terms of financial "stability" within the context of existing trade and investment patterns rather than in terms of structural reformation. In this respect it continued to be concerned above all with warding off a repetition of the great economic dislocations which had plagued the 1920's and 1930's—dislocations generally triggered by balance-of-payments constraints upon domestic policies which imposed deflation and great slowdowns in economic activity. The Bank sought financial stability on the grounds that this would serve to accelerate economic growth in all its member countries. Beyond a point, however, "financial stability" spells social rigidity, and this was the rub. By 1951 a group of United Nations experts observed that, "What is important is to build up the capacity of underdeveloped countries to produce goods and services. The Bank should start from this point rather than from the measurement of foreign currency needs. And if development succeeds, the transfer problem of meeting the debt charges should take care of itself. At present the Bank puts the cart of foreign exchange difficulties before the horse of economic development."[19]

As described in the preceding section, the World Bank and the IMF were designed to solve certain problems. The bringing about of a revolution in agricultural productivity was not one of these problems. Nor was social restructuring of any kind. As a result, the problems of backwardness were left essentially untouched. Looking backwards, one might say that from the beginning the World Bank's development strategy did not extend beyond the area where industrialization of the backward countries directly served U. S. and British interests. Believing that some liberal "harmony of economic interests between the more and less developed countries" existed, Secretary of the Treasury Morganthau voiced the theory that "the process of industrialization, without which improvement of living standards is unattainable, can be most efficiently accomplished by an increasing volume of imports of machinery and equipment. And what could be more natural than for India and China to import such goods from England and the United States with their vastly expanded capacity for producing such goods?"[20] World Bank and

[19] United Nations, *Measures for the Economic Development of Underdeveloped Countries* (1951), p. 82.

[20] *Senate Hearings*, p. 611 (quoted from his article on "Bretton Woods and International Cooperation," *Foreign Affairs*, January, 1945).

IMF lending activities thus financed a large-scale exportation of capital goods and engineering services from the United States and other developed countries without actually financing the development of those sectors—above all agriculture—that might have tended to displace U. S. exports. To a large extent, of course, this has been the fault of the backward countries themselves for not pressing World Bank loan philosophy further into the realm of their own interests. Given the fact that World Bank representatives are appointed by their governments, however, and given the fact that many governments in the backward countries owe their support to economic classes whose interests are hardly those of their rural populations taken as a whole, one can understand why they did not press the issue of agricultural modernization, and why they did not emphasize the distinction between growth within a healthy institutional structure and the problem of modernizing this structure.

Quite apart from overt economic interest, of course, the failure of the World Bank's loan philosophy has also been the result of spurious economic theory: the doctrine of comparative advantage has continued to dominate academic economics, while what "growth" theory as has been enunciated in postwar years is generally dominated by income theory rather than structuralism. In applying the precepts of Keynsianism to the backward countries the World Bank has shown its thinking to be dominated largely by the problems of the past which plagued developed nations, not the problems of the present which plague the backward ones. What is needed for economic improvement of the backward countries, it is taught, is "funds" to purchase "technology." Modernization, it is believed, will take care of itself given adequate technological resources.

The Bank's articles of agreement constrained it to work through the institutions of status quo. For one thing, it was permitted to lend only to governments and official government agencies. The reasoning behind this constraint was that a major problem of interwar lending had proven to be default, which was basically a problem of creditworthiness on the part of private sector borrowers. Riskiness of investment had been one of the major factors during the interwar period dictating high interest rates to borrowers in the underdeveloped countries. It was largely to reduce this risk component of borrowing charges by these countries that the Bank restricted its loans to governments, on the grounds that through this provision it in effect obtained an official governmental guarantee against default. However, by solving one problem, it created another: inasmuch as many governments were and are dominated or blocked by those very classes whose power must be reduced by the process of economic modernization, particularly in agriculture, this provision limited the Bank's ability to transform social institutions in the backward countries.[21]

Another problem of interwar lending that the Bank sought to overcome was the fact that bilateral aid in the past had all too often been accompanied by political pressures, granted as part of an economic, political or military trade-off (as it is today). To assure that the Bank would not be involved in this, the framers of its articles of agreement prohibited it from using economic pressure (i.e., the withholding of loans) as a political lever with which to effect domestic economic change (Art. IV, sec. 10). However, by solving one problem the Bank once again created another: it was just such pressure and just such change that was needed to bring about revision of fiscal policies and modernization of land ownership patterns in most of the Bank's customer-countries.

The effect of this prohibition against social pressure was in fact to curtail any deliberately positive political pressures that the Bank might have exerted, while ironically not really preventing it from indirectly exerting other social pressures: borrowing countries found themselves tied to the comparatively conservative financial policies and philosophy of economic growth implicit in the Bank's lending operations. As a precondition for receiving development aid they were required to undertake "stabilization programs" which not infrequently resulted in widespread strikes, unemployment and political upheavals, and which froze existing inequities rather than dissolving them.

The Bank was precluded by its articles of agreement from extending loans in domestic currency, the rationale being that some degree of "self-help" was necessary to prevent the squandering of funds on unproductive projects, something which had indeed characterized many of the interwar aid loans to governments. However, while this "foreign currency" provision had the positive effect of requiring loan-recipients to commit a substantial amount of their own funds to finance the domestic expenditure portion of their development plans, it unfortunately precluded Bank lending in such areas as financing land purchase and reno-

[21] Thus J. J. Spengler observed over a decade ago that, "it being the purpose of a mission to induce action on the part of the government of a visited country, its recommendations must be limited to those which it feels that the government can, as a practical matter, carry out. Accordingly, missions must necessarily refrain from suggesting institutional or other changes which are completely beyond the scope of practical politics." ("I.B.R.D. Mission Economic Growth Theory," *American Economic Review*, May 1954, p. 583).

vating the agriculture of backward countries, the financing of rural credit facilities and cooperatives, the development of a crop-distribution infrastructure, and other projects calling mainly for domestic currency expenditures.

Finally, the Bank was permitted to make loans for "productive purposes" only, with "productive" being defined as capable of generating a financial surplus to amortize the loan and pay interest on it. The concentration of Bank loans for self-liquidating projects such as electric power utilities was taken in many quarters to imply an identification of growth with monetary accumulation rather than with social change. A report published by the RAND Corporation in 1958, for example, concluded that because most of the Bank's loans had been for electric power utilities and transportation, "it is clear . . . that the Bank regards these kinds of investment as the key to economic development."[22] Such criticisms may seem ill-taken in view of the emphasis placed upon agricultural development by most of the World Bank survey missions, and by the more recent emphasis on the International Development Agency (IDA), the Bank's "soft loan" affiliate. It would probably be more appropriate to say that while the Bank fully realized that profitable loans could finance only a small component of the backward nations' total development needs, it was prohibited by its articles of agreement from making loans for any purposes *other* than those which generate a revenue sufficient to amortize its loan with interest. The Bank, after all, makes loans by borrowing in the open market at going commercial rates, supplying these funds to borrowing countries with a 1 per cent-1 1/2 per cent premium as "suitable compensation for its risk." It has itself decried the lack of suitable projects to qualify for its investment loan funds (although the fact that so many of the backward nations have today reached virtually the limit of their anticipated debt-servicing capacity would in any case exclude them from further borrowing on "hard loan" terms).

As a result of the constraints built into its articles of agreement, the World Bank is able only to make loans to or through governments. It cannot apply political pressure for necessary structural change, nor, in foreign currency, finance the import-needs of these countries' development

[22] *The Failures of the World Bank Missions* (Publication P-1411, June 24, 1958), p. 82. See also p. 9, where it is asserted that "The Bank has also established various criteria for its loan activities. It is required that loans be for 'productive' purposes, though the meaning of the term is not that of economists but is synonymous with 'profit making.' "

plans. It must make loans for "productive" purposes only, that is, for projects directly able to generate a financial surplus. The result of these policies has been that in the last twenty-five years Bank lending has been mainly for electric power production and transportation of goods (largely those produced by the export sector). To the extent that the Bank has been able to make loans for agricultural purposes it is perforce constrained to finance only agricultural technology imported from the more advanced nations.

This institutional limitation has naturally bolstered the unfortunate belief that merely technological or financial inputs may suffice in themselves to assure economic evolution. Underlying this theory is the assumption that highly sophisticated capital can be applied by quasi-serfs (such as Chile's *inquilinos*) on rented land as readily as by trained farmers on large American family-owned farms. So long as these institutional constraints and this technological philosophy persist, however, the Bank's lending policies will remain unable to solve the problems of structural backwardness. It is the thesis of this argument that sophisticated agricultural technology is barely relevant in agriculturally backward food-deficit countries so long as present institutions of land tenure prevail. Of course new seed varieties and fertilizers might increase output on an Indian farm one foot wide and fifty feet long—but to what avail? Of course a Chilean *inquilino* could, technologically speaking, apply fertilizers to his plot of land and increase crop yields. But he would be utterly thwarted by the country's archaic system of land tenure, under which his increased yield would be appropriated by the landlord. The whole point is that technology is *not* something merely technical but is *social* in nature. Can any other thesis explain why Chile, whose food imports have absorbed virtually *all* her balance of payments gains from copper mining since 1952, is a net *exporter* of guano and other nitrates, or why India, with 20 per cent of the world's cattle population, should find most of her citizens on milk-deficit and meat-deficit diets? The promise of modern technology holds out a bright *potential* for future world food output, but it is a potential that cannot be realized under today's structural constraints which plague the agriculturally backward countries.

Because the Bank's agricultural lending is limited to the importation of a farm technology inapplicable by the vast majority of the tillers of the backward countries' soil, it can only aggravate the "dual economy" structure of these countries. Because the Bank is only permitted to lend to governments themselves, without any option of laying down social conditions for its loans, its lending activities have already worked to entrench existing governments despite their failure to lead their countries to the point of self-sustaining take-off. The result has been inability of the Bank to play a leading role in the *social* revolution so clearly needed by the backward countries. Transformation of land tenure institutions has been deemed to lie outside the realm of the Bank's development activities, as have most of the social, political and other less commercial aspects of development.

Some Bank economists and survey missions have taken pains to assert that the Bank's aim is *not* to achieve an agricultural revolution upon which to base industrial development, but merely to increase productivity in whatever sector offers the greatest opportunity. Representative of this attitude is the report of the Bank's first survey mission sent to evaluate Colombia's economy: "Increased productivity," the mission asserted, "permits the release of resources that can be devoted to the production of more essential or useful objects. Hence, it is not a question of stressing productivity per capita, or efficiency, in all fields. . . ."[23] Emphasis was placed on industry, which under prevailing conditions in most food-deficit countries offers greater scope for specialization of labor than does agriculture. This relative productivity relationship stands in sharp contrast to the experience of the United States, the productivity gains of whose farmers in the postwar period have outstripped those of any industry in any country of the world. The gains from industrial growth were portrayed as consisting of import-substitution in industrial manufactures. Not emphasized were the losses suffered in the form of "external diseconomies" associated with a dual economy—a rural exodus into the cities and a decline in agricultural productivity, often catalyzed (as in India) by pricing policies aimed at reducing crop prices rather than supporting them at a level sufficient to induce a broad application of capital to land. On balance these external diseconomies often exceed those entailed by institutional reform and primary emphasis on agriculture as the basis for balanced economic growth.

Such World Bank chief economists as John H. Adler, the director of the Nigerian survey mission, have asserted that "while it may be true that emphasis on agricultural improvements may yield positive and welcome results in the form of larger availabilities of foodstuffs and agricultural raw materials, and therefore of a higher real per capita income, these improvements will not set into motion a cumulative process of de-

[23] *The Economic Development of Colombia* (Baltimore, 1950), p. 354.

velopment which has characterized the economic history of the countries which enjoy the highest per capita income."[24] In one sense this is true: the development of a large plantation, export-oriented agriculture will have no more salubrious impact in creating a "home market" or nurturing a trained class of rural entrepreneurs in today's backward countries than it did in the Southern United States prior to the Civil War. Should such a pattern of agriculture be pursued of course, it would indeed be exactly the reverse of the historical development of today's industrial nations, whose industrial growth was built upon the foundation of a successful agriculture. However, this is all the more argument for insuring that agricultural growth and institutional transformation is broadly based, so that its external economies may extend to all sectors of the backward countries.

Despite such examples of the Bank's anti-agricultural prejudice, however, and despite the detrimental effect of established rural institutions upon overcoming the food-deficits which have emerged in the backward countries, primary emphasis has been placed by most World Bank survey missions on developing the agricultural sector. The missions are generally in agreement that agriculture provides the greatest number of forward and backward linkages, affects the largest sector of the population and generates the major portion of income in most of these countries.[25] The missions have been among the leaders in enumerating the disadvantages of land tenure systems characterized by insecurity of title or proprietorship, and of tenant-farmer and *inquilino* institutions which stifle incentive by those who actually work the soil. Generally, the missions are in accord with the observations of the United Nations studies of *Land Reform* and *Progress in Land Reform*. The former study asserts that, "In the first place, the tenant has little incentive to increase his output, since a large share of any such increase will accrue to the landowner, who has incurred no part of its cost. In the second place, the high share of the produce taken by the landowner may leave the peasant with a bare subsistence minimum with no margin for investment... Thirdly, it means that wealth is held in the form of land, and that the accumulation of capital does not lead to productive investment."[26] Other disad-

[24] "Fiscal and Monetary Implementation of Development Programs," *American Economic Review,* May, 1952. The reason, asserts Dr. Adler, is mainly because of the absence of the external economies which occur in industry.

[25] See for instance the reports of the World Bank's missions to *Ceylon* (pp. 108-09), *Nicaragua* (pp. 29, 31), *Syria* (pp. 35-36), *British Guiana* (pp. 25-26), *Guatemala* (pp. 23, 27), *Iraq* (p. 4), *Nigeria* (p. 192), *Turkey* (pp. 32, 57), *Tanganyika* (pp. 5-6), *Jordan* (p. 12), *Uganda* (pp. 15-17), *Thailand* (p. 4), etc., etc.

[26] *Land Reform* (New York, 195), p. 18.

vantages of existing patterns of land tenure have been enumerated by World Bank missions. The mission to Ceylon observed that land without title cannot be used as security for loans, and that "insecurity of title also means that he [the peasant] will find it impossible to borrow, even for improvements to his land."[27]

The mission to Jamaica believed that "The size of farms... is more important than questions of ownership and tenancy. Many farms are too small to support a family."[28] Often, as in Colombia, the two extremes of excessive fragmentation of land and excessive holdings are to be found side by side. "Large numbers of farm families... trying to eke out an existence on too little land, often on slopes of 50 or even 100 per cent (45 degrees) or more. As a result, they exploit the land very severely, adding to erosion and other problems, and even so are not able to make a decent living."[29] In the face of such methods, although "the good, level, arable land situated near populous centers is strictly limited," it is for the most part "devoted to the grazing of cattle, and is customarily owned by absentee landlords."[30] The mission gives first priority to the solution of what the United Nations has termed the "uneconomic and paradoxical use of land."[31]

Farm size is of course inexorably linked with the problem of land tenure, as are the problems of introducing improved technological practices, providing rural credit and marketing facilities, and modernizing the taxation systems in the backward countries. So long as the World Bank is precluded by its articles of agreement from fostering development in this direction, it cannot claim to make the needed beginning in renovating the agricultural sectors of the backward countries and enabling their domestic farms to feed their growing populations.

Modern agricultural technology gives no nation any excuse for being in a food deficit position save the case of very small industrial countries such as England. Certainly no country whose human resources are primarily devoted to agriculture—such as those of Latin America and Asia—may be condoned for regressing from food-surplus to food-deficit status since World War II. This is emphatically *not* to say that all that is

[27] *The Economic Development of Ceylon* (Baltimore, 1953), p. 362. See also *The Economic Development of Tanganyika* (Baltimore, 1962), p. 94.
[28] *The Economic Development of Jamaica* (Baltimore, 1952), p. 161.
[29] *The Economic Development of Colombia*, p. 63. See also p. 360.
[30] *Ibid.*, p. 383.
[31] *Progress in Land Reform* (New York, 195) p. 185, which cites many other instances of this dual economic structure. See also the reports of the World Bank missions to *Malaya* (p. 314), *Ceylon* (p. 360), *Syria* (p. 68), *Surinam* (p. 119), etc.

needed is to transfer sophisticated agricultural technology to the food-deficit countries. The entire point is rather that this technology is *irrelevant* to these countries so long as their present institutions of land tenure and of food pricing and distribution remain untransformed. It is the failure to have helped bring about this transformation that represents the major shortcoming of today's international lending agencies.

III

The overriding development in postwar international finance has been the evolution of the U. S. balance of payments from surplus to deficit. As this has occurred, a fundamental inequity has become apparent in the "key currency" standard: increases in international liquidity over and above newly-acquired gold must derive solely from the balance of payments deficits of the key currency nations. Ideally under the system, the key currency nation—that is, the United States—would purchase in the neighborhood of $1 billion more goods, services and capital assets from foreigners than they purchase from it. As a result, it is given a unique right to obtain an equivalent sum of other countries' resources, since these countries use the dollars not to purchase a reciprocal flow of resources from U. S. residents but merely to augment their international currency reserves. The effective result is a "cost-free" transfer of foreign resources to the United States.

The problem since 1958 has been that U. S. payments deficits have considerably exceeded $1 billion annually. By 1964 foreign countries' dollar holdings had come to exceed U. S. gold holdings, making the key currency no longer freely convertible into gold. The constraints imposed by the international gold standard were suspended: world liquidity beyond this point became a function of monetary and fiscal policy in the key currency country, with the rest of the world drawn inexorably into its orbit. As a consequence, U. S. domestic expansionary pressures have been transmitted abroad. European countries have found themselves effectively forced to accept the dollars thrown off to a sum equivalent in magnitude to that of U. S. overseas military spending, or (alternatively) to new U. S. industrial investment in Europe. Stated another way, Europe's central banks have thus found themselves locked into a position of financing this country's foreign military operation and/or its takeover of European industry. To withdraw from this strategic disadvantage, they must—given America's reluctance to settle its deficits with gold

—risk the threat of throwing the international payments system into crisis, and with it their own economies.

This is a problem the IMF was not designed to bring about, much less solve. It was intended to enforce the rigors of the gold standard, not to evade them. For however irrational gold may appear to some observers at some periods of history, it is less irrational than paper. Theoretically, the only safeguard against the United States as the key currency nation buying up the entire world with its printing presses is the discipline of gold. This discipline is no longer operative.

The history of money and banking has been one of society's attempts to relate the growth of its money supply—both domestically and internationally—to that of overall economic activity. Historically the self-regulating mechanism elected for this task has been gold (and, to a lesser extent, silver).* In the 19th century gold served to maintain a certain equilibrium among nations. Most nations backed their national currency with gold and silver bullion. When their residents spent more abroad than foreigners returned, their treasuries were obliged to part with their bullion and to reduce their domestic money supply accordingly. The deflationary effect of this process led at some point to a reduction in domestic prices, often through the mechanism of a financial panic which saw the prices of capital investments reduced even more than those of goods and services. Countries undergoing this process found their resources becoming relatively more "competitive" with those of other countries, and ultimately "normal" goldflows and currency growth were resumed. This restoration of international equilibrium was the classical adjustment process.

Private commercial commercial banks in the United States during the 19th century issued their banknotes against such assets as government securities rather than bullion. So long as their noteholders felt that they could cash in these notes for coin or equivalent assets at face value on de-

* In principle any rare commodity would have served whose world production increased at a rate roughly approximating that of world income, and whose use as a monetary commodity did not entail great economic inconvenience. (Had copper been chosen as the monetary metal, for instance, growth of world electricity supply would probably have been impaired. Had grain been chosen, a world inflation would most likely have ensued. Had emeralds been chosen, a world deflation would inevitably have taken place.) Gold was agreed upon among nations because it was the most equitable and democratic of metals: Holdings of gold were fairly widely dispersed, and the growth of world currency supplies was slow enough to roughly match that of world income. Only in periods of vast new sources of gold supplies, such as the looting of South American empires by Spanish conquistadors in the 16th century, did the world's supply increase so much more rapidly than world economic activity as to result in monetary inflation.

mand, they generally felt no desire to do so. Their gold-equivalent was safer in the banks than in their own homes or places of business, and banknotes were more convenient than gold coins. Private banknotes came to supplement gold and silver coinage and their paper tokens.

However, the history of most nations has been marked by periods when some banks inevitably overissued their notes, thereby defrauding their noteholders and depositors. In the case of privately owned banks the overissue was destined for the pockets of their owners and managers to purchase real goods, services and capital assets from society. In the case of government banks, overissue resulted in a similar transfer of society's income and wealth to the government sector (as in the case of greenback financing during the Civil War). This practice led to panic which swept under not only the guilty banks but healthy ones as well: depositors and noteholders feared that because other individuals and businesses were probably cashing in their notes for more liquid assets they themselves must act defensively and cash in what notes and deposits as they held. The result, of course, was that banks failed, since only a fraction of their note-issue and deposit-liability was held in the form of coin and other liquid assets.

It was thus to save their own lives that responsible banks pressed state and government agencies to enact laws limiting the ability of banks to issue notes and carefully prescribing the types of assets in which banks might invest their deposit liabilities. In short, a set of disciplines was imposed to supplement the discipline of gold. A similar evolution will hopefully characterize international finance.*

* As financial ties between nations increased during the 19th century, the pound sterling, which was freely convertible into gold on demand, came for reasons of convenience and security to be accepted as readily as gold itself, just as in domestic banking private bank notes—at least those of healthy banks—came to be accepted on a par with gold. Britain became the first great international banking nation, running its empire on the "sterling exchange standard." World War I diminished Britain's financial power, however, while enormously increasing that of the United States. The dollar joined the pound sterling in its privileged "key currency" position. Because the dollar was in universal demand and because the great size of the U.S. gold stock assured that the United States would have no difficulty in redeeming foreign dollar holdings with its gold, foreign countries chose to hold their international reserves as readily in dollar-deposits in New York as in gold. (This was done not only for convenience and safety's sake, but often because their gold itself was held in New York as collateral for dollar loans, thus "leveraging" the foreign reserves of central banks.) The workings of this dollar-exchange standard can scarcely be said to have been inequitable as such, since the United States did not—like some private wildcat banks of the 19th century—choose to print up dollars to purchase foreign goods or assets without having any monetary resources to back up these purchases. The dollar remained freely convertible into gold. It was the banks of France and Germany that were at this time the wildcat banks and they paid a similar price for their overissue, namely that of seeing their notes depreciate in value to a fraction of their face amounts.

Following World War II the dollar was in universal demand as countries chose to hold substantial portions of their reserves in New York, either in the form of gold bullion or as dollar deposits. (Funds continued to be held in London by sterling area countries, to be sure, but largely because they were effectively frozen there or because they represented minimum working balances.) The United States was in strong balance of payments surplus throughout this period, and continued to absorb foreign gold into its own reserves. Only sometime after 1952 did the inequity of the dollar exchange standard become apparent: the banker began to run a deficit whose proportions exceeded that required for international means of payment. Its movement into deficit was at first welcomed by foreign governments, for as their private residents found themselves accumulating dollars more rapidly than they were spending them in the United States they turned them over to their central banks in exchange for domestic currency. These central banks in their turn added the dollars to their foreign exchange reserves. The dollars accumulated in this way by foreign central banks during 1952-1960 represented a form of cushion to meet prospective fluctuations in their balance of payments. They were kept in dollars essentially for convenience' sake. (Of the $17.5 billion in U.S. balance of payments deficits during this period as measured on a "liquidity" basis, about three-fourths was held in dollar form, only one fourth cashed in for gold, virtually all of this during 1958-1960.)

By 1960, however, what had been a dollar gap turned into a dollar glut. Foreign governments generally felt they had accumulated enough dollars for working needs, and began to emphasize the role of gold as the most equitable international asset. It was at this time that they began to urge the U.S. government to take serious steps to contain its overseas spending, particularly in view of the fact that the major factors in the U.S. payments deficits were overseas military spending and private capital investment in Europe. To draw an analogy with 19th century banking practice, it was as if the United States were a wildcat bank printing up cash to buy up investments in its society, adding these investments to its asset-base to "justify" its having printed the currency to acquire them. (To draw another analogy, its position was not unlike those of the corporate raiders of the 1920's who would borrow cash from banks to purchase a cash-rich corporation, and then raid the corporate treasury to repay the financiers once the takeover was completed—a practice forbidden domestically since that time by SEC regulations.)

Despite foreign pressures for the United States to curtail its deficits it chose instead to increase them, both through direct U.S. government expenditures abroad (mainly on military account) and through expansionary domestic policies. To finance these growing deficits it joined Britain in proposing an expansion of IMF resources, through the mechanism of increasing member nations' quotas across the board so that a greater pool of currencies would be available from which it and Britain might borrow. The Common Market nations, however, were adamant in opposing an increase in international liquidity simply to enable the United States to run its deficits unchecked. They called for it to put its house in order, just as the healthy banks in the 19th century had sought to avoid the plague of wildcat banks and their flood of currency. Expansion of IMF quotas for the purpose of helping the United States sustain its deficit, they warned, would be in clear violation of Section 13 of the IMF charter, which specifically prohibited IMF credits from being used for more than temporary stabilization purposes. The German representative to the IMF's 1963 meetings stated:

> I should like to warn against the illusion that, as if by some purely technical reform, one could solve in an automatic or painless way the adjustment problems which are due either to structural distortions or to policy discrepancies between the member countries of our international system. . . .
>
> I want to stress that any improvements that might be thought out for our international monetary system . . . should not be concentrated only on the question how best *to finance* balance of payments deficits, but also on the even more important question of how to provide sufficient incentives for *curing* them.[32]

Article VI of the IMF agreement forbids its resources to be used to finance deficits on capital account, something which the United States seemed to be using them for. Common Market economists complained of America's growing investment in European industry and correlated this with the U.S. payments deficit to demonstrate that the United States was in effect obtaining a cost-free take-over of Europe. Private U.S. investors spent dollars to buy private European enterprises, the European recipients of these funds preferred to turn over the dollar proceeds to their central banks for local currency (or other, non-dollar currencies), and the central banks found themselves obligated for political reasons to refrain from cashing these dollars in for U.S. gold on the grounds that this would disrupt world financial conditions. As a result the United States was annually spending billions more on capital assets than foreigners spent in the United States and was unwilling to relinquish its privileged status.

[32] IMF, *Summary Proceedings: Annual Meeting, 1963*, pp. 90-91 (italics in original).

It was to stop this nationalist monetary strategy that the Common Market nations succeeded in having the IMF's 1963 annual report conclude that there was no overall shortage of world liquidity and in getting the United States to concur that, in the event that an increase in world liquidity would be enacted through an increase in IMF quotas, it would not be discharged from its obligation to reestablish balance in its external accounts.

During 1964 Europe became more adamant in its protest against having to finance the U.S. deficit. Kurt Blessing, the German representative to the IMF's 1964 meetings, announced that:

> I would have preferred to see the annual Report place greater emphasis on the need for stricter monetary discipline on the part of the deficit countries [i.e., the United States and Britain]. I am entirely in agreement with those who think that supplies of gold and reserve currencies are fully adequate for the present, and are likely to be for the near future...
>
> I am glad that the review of the existing international monetary system has not led to any basic change. In my opinion, there is not so much need for an improvement of the system as for an improvement of national policies of adjustment. No system, however ingeniously conceived, can function satisfactorily without monetary discipline. Under the system of fixed exchange rates, even countries with sound monetary policies have to import inflation if other countries do not maintain sufficient monetary discipline. If we want to avoid further creeping inflation, deficit countries, too, must take corrective measures, however painful they may be.[33]

Under a too-abundant provision of international liquidity, the Dutch representative (Mr. Holtrop) concurred, "corrective internal policies may be delayed too long and the inflationary tendencies will tend to prevail." "There is agreement," he concluded, "that it is both unlikely and undesirable that in the future the supply of international liquidity, originating from the balance of payments deficit of the United States, should continue to flow at the present rate."[34] Italy concurred with the "proposed 'multilateral surveillance' of the means of financing balance of payments disequalibria," while France added its voice in warning that "excessive facilities may be granted which may lead to the spreading of international inflation. It may even lead to the strange paradox that, since the system in practice permits the deficits of the reserve currency coun-

[33] IMF, *Summary Proceedings: Annual Meeting, 1964*, p. 113.
[34] *Ibid.*, p. 64.

tries to be financed without limit, the creditor countries are somehow in-invited to 'create a deficit' in order to compensate for the outflow of reserve currencies, which is a phenomenon for which they have no responsibility however."[35] France thus spoke for all six Common Market countries in urging that "reference will have to be made to gold" in financing future balance of payments deficits, as "the only monetary element outside the scope of government [i.e., unilateral nationalist] action."[36]

Europe's voice remained ineffective, however, as the United States defaulted on its announced intent to restore equilibrium in its balance of payments (although it did apply such palliatives as the tying of foreign aid to purchases of U. S. goods and services, the Interest Equalization Tax, and controls on the growth of foreign investment by U. S. banks and corporations). The crowning blow to Europe's wishes, however, was growing U. S. insistence upon the need for expanding international liquidity through structural reform of the IMF. Its reasoning was essentially as follows: for world trade to continue growing at current rates a proportional increase in world liquidity was necessary. This was not being supplied by newly-mined gold largely because of private hoarding. The balance must come either through increased use of the dollar as the key currency or through "Special Drawing Rights" along the lines decribed by Keynes in his 1943 plan for an international clearing union. Under this latter plan the Fund would cease to be a mere pool of national currencies, but would provide overdraft facilities for use by deficit-nations (presumably in whatever currencies they desired).

Europeans replied that the function of international liquidity was not to finance *trade* so much as *imbalances* in world trade and payments. Exports and imports could multiply tenfold, but if they remained equal and in balance, there would be no increase in any deficit to finance. What was needed was economic policies in the deficit countries aimed at balancing their international payments, not financing of basic payments disequilibria by the surplus countries.

During the gold crisis of 1967-68 the Common Market nations joined in insisting on a larger voice in the IMF. American authorities at first replied that they could achieve this only by increasing their capital subscription to the Fund, thereby increasing the Fund's resources (and American drawing potential). The European countries were unwilling to comply. Nor were they at first willing to activate SDR's until the United States had restored equilibrium in its balance of payments—

[35] *Ibid.*, p. 107.
[36] *Ibid.*, p. 206.

a condition which seemed clearly impossible so long as the war in Southeast Asia continued to drain U. S. resources. However, under threat of an international monetary breakdown the Common Market nations gave ground: foreign trade amounted to some 25 per cent of their national income in contrast to only 3 per cent for the United States. A monetary breakdown would thus plague their economies to a considerably greater degree than that of the United States. Their policy was therefore to avoid a breakdown of negotiations at all costs. They settled for arguing the United States down from a planned $5 billion annual creation of SDR's to a rate of from $2 to $3 billion (of which the United States could draw about one fourth, or from $500-$750 million). The United States on its part agreed that an 85 per cent majority would be required to activate these SDR's, thereby giving the Common Market countries, with over 15 per cent of the voting rights, veto power over this decision.

Much as England had asked the United States in 1945 to reinvest the proceeds from its foreign investments abroad so as to help "stabilize" the deficit countries of the world the United States asked Europe to reinvest the dollars thrown off by its deficit in the U. S. economy in the form of special Treasury securities and other assets. Europe in effect had little choice: its official dollar balances were in effect frozen just as the sterling balances had been in 1945: they could not be cashed in for American gold, since their size ($12.5 billion by year end 1968) exceeded that of the U. S. gold stock by some $2.1 billion. They were necessarily obliged to invest some $7.0 billion of these funds in U. S. Treasury securities. A dollar bloc, financed by blocked dollar deposits, had been created.

As described in the first section of this essay, the United States had succeeded in 1945 in basing international power firmly upon gold. Because it held most of the world's gold, this power devolved upon the U. S. gold stock. Now that this gold threatened to return to Europe, America saw its international financial power dwindling, just as England before her. Gold, it realized, was power, and if its gold was flowing out, then the basis of power had to be changed to some other institution if its diplomatic and financial hegemony were to be maintained. The United States responded by attempting to shift the basis of international power away from gold and towards debt: it agitated for special drawing rights as a means of financing its economic power. In short, its doctrine of international finance evolved into the exact opposite of that voiced in 1945. It spoke of its gold sales to Europe as gold "losses," as if it were *its* unique gold that was being "lost," when actually this gold, drawn so largely from other nations, was being dissipated in its war in Southeast

Asia and used as the basis for its profitable investment in the economies of Europe, Japan and less developed countries.

It had used the dollars that it had technically borrowed from Europe during 1952-1960 to invest in foreign assets comprising military bases and direct investments abroad. When Europe balked at lending further amounts to maintain and augment these military and business investments, and asked to cash in for gold further debt-instruments of U. S. residents and government agencies, the U. S. Treasury balked at constraining its foreign expenditures or at liquidating these assets to repay Europe. It portrayed the unique economic autonomy from balance of payments constraints that it had enjoyed during 1920-60 as its natural right, and spoke with bitterness of European surpluses tending to constrain this autonomy. Just as Britain had hoped in 1945 to draw upon IMF and World Bank resources to finance its chronic deficit on current account for as long as possible, so the United States is today hoping to borrow from Europe via the IMF and World Bank to maintain the growth of its foreign assets and prevent the repatriation of its gold to Europe.

This result of IMF lending was not readily foreseeable in its 1945 articles agreement. Nor was the rapid depletion of America's financial strength, even as recently as 1960 when the decision was taken to commit its resources to the war in Southeast Asia and the Cold War missile program. Intentional or not, however, the workings of the IMF and IBRD have worked to provide an extraordinary degree of support for U. S. diplomatic designs for the world, designs which in their turn have shown themselves to be inequitable to the majority of the IMF-IBRD member countries.

What is needed today is not an implementation of American empire but a solution to the problems brought about by the U. S.-British payments deficit and by the failure of the backward nations to develop more than token signs of economic progress. It is necessary for more people to realize that the "solutions" proclaimed by the United States within the IMF and World Bank are inappropriate to solve the problems at hand. Within the IMF, the act of *financing* the deficit countries scarcely helps them to *cure* their deficit—if anything, it induces them to continue their untenable policies. Within the World Bank, the solution to poverty in the backward countries cannot be found in simplistic proposals for population control and a transplanting of modern technology to aggravate their dual economic structure. Rapid population growth is a symptom of poverty, not its cause (although admittedly it works to burden the struggle out of poverty in its initial stages). Nor is the solution merely technological: by announcing its intent to quadruple its agricultural lending during the next five years—largely for the importation of modern agricultural technology to become an isolated sector in the agriculturally backward countries—the World Bank is scarcely tackling the problem of backwardness in the places where it exists. It is merely pushing the rural poor off the land onto urban reservations, to be supported by isolated pockets of modern technology. It thus wishes to repeat the unfortunate demographic movement that has plagued the United States over the last two decades, as its rural poor have migrated *en masse* to its "inner cities" virtually bankrupting them with a "welfare" overhead in the process. Finally, by stepping up its rate of lending at all, when already four years ago George Woods—McNamara's predecessor as president of the Bank—was observing that the debt-servicing capacities of most of the backward countries were already filled up, the Bank is inducing these countries further into a position where they must depend upon a continual recontracting of their indebtedness to foreign central banks, primary among which is the U. S. Treasury, along with AID and Eximbank.

It does not lie within the scope of this essay to outline the solutions to the problems discussed above. Promising solutions that have been suggested have generally been repudiated by the World Bank and IMF management, partly because they exceed the scope of these institutions' philosophy of economic development, and partly because in many respects they self-evidently do not lie within America's preferences for the course of world economic evolution. What is necessary is that recognition of the built-in shortcomings of the fund and bank be more broadly spread among the less developed countries, and that a doctrine more appropriate for their economic growth be put forth. That this doctrine will be neither "classical" nor Keynesian is by now apparent. That many existing governments are unlikely to find such a doctrine in their own self-interest is also apparent. That they will attempt to continue financing their backwardness, instead of financing their struggle out of backwardness, seems likely. That a solution to their problems can be found short of revolution seems unlikely unless a new operating philosophy of international development is enunciated to supplant that which characterizes the bank and fund today and which is largely implicit in their present power structure. The solution probably cannot be of their own finding. The day of atonement is therefore at hand.