BRETTON WOODS REAPPRAISED

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I

The International Monetary Fund and the International Bank for Reconstruction and Development were established and have passed their infancy under a barrage of criticism. There were originally grave doubts as to the wisdom of creating the institutions at all. Four years of operations have been attended by a wide range of adverse comment, varying from attacks on the salary and allowance scale on the one hand, to accusations of perversion and misuse by the United States on the other.[1] The main criticism has been, however, that the institutions were inadequate to meet the economic problems of the postwar world. Evidence for this may be found positively in the proposals for drastic revision of the articles and practice of both institutions put forward by an international group of experts in a United Nations report,[2] and negatively by the recommendations of the Gray report, which calls for stabilization-fund loans to European countries to meet the problem once solved by the establishment of the Fund, and an expanded Point IV program, with additional funds for the Export-Import Bank, to assist the Bank in the discharge of its long-run task.[3]

A substantial increase in United States imports under the impact of devaluation and of defense spending because of the Korean war has eliminated, at least for a time, the chronic postwar surplus in the dollar balance of payments. The immediate pressure of the dollar shortage has been relieved. This then may be a good occasion for renewed examination of the Bretton Woods institutions.

In part such examination should be directed to the questions of how the organizations have fulfilled the functions they were designed to perform, and to what extent these functions represent real needs. But this is not enough. International organizations to a great extent make their

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[1] See Polish letter of withdrawal, International Monetary Fund, *Annual Report,* April 30, 1950, p. 102–103.

[2] United Nations, *National and International Measures for Full Employment,* a report by a group of experts appointed by the Secretary-General, December, 1949.

[3] *Report to the President on Foreign Economic Policies,* Washington, D. C., November 10, 1950, especially p. 64–66, 96.

own jobs. They are established with a charter detailing their powers and a set of purposes. In the nature of the case, however, both purposes and powers must be reshaped in the light of circumstances which can only dimly be foreseen at the time of their foundation. If useful work is to be performed, international bodies must be modified by legislation or by practice to fit the real world. An important part of this investigation is to assess the extent to which the Fund and the Bank have responded to this challenge since their emergence from the theoretical world of Bretton Woods.

II

By the unfair test of maximum hopes, the Fund and the Bank have clearly failed. The wartime international economic conferences, at Hot Springs and Bretton Woods, drew simple and grand designs for the postwar world. With a relief and rehabilitation agency (UNRRA) to manage the immediate postwar period, the world economy could be set to rights essentially by two lending and two control agencies. The Food and Agricultural Organization would operate within its particular sphere which needed special handling. For the rest, the world economy could be set and kept in balance by an international bank to handle immediate and long-run capital needs, a fund to correct exchange instability and to tide countries over temporary difficulties, and a trade organization (ITO) to make rules for the conduct of commerce. ITO would not need loanable funds. The International Bank would have some $8 billions at its disposal, plus borrowing capacity; the Fund another $8 billions. To be sure, if one looked simply at the United States dollars at the disposal of the lending agencies, the total of $16 billions without borrowing capacity had to be marked down to some $6 billions representing United States subscriptions, plus a gold and dollar portion of those of other countries.

This simple scheme had to be amended before it got under way. In the relief area, civilian lend-lease and military relief were needed before UNRRA got organized. Government relief in occupied areas was required to parallel the work of UNRRA in defeated countries. And after the dissolution of UNRRA there were successively post-UNRRA relief and Interim Foreign Aid. Lending activities also began before the organization of the Bank and Fund. Apart from surplus property sales on credit, there was the increase in the capital of the Export-Import Bank by $3 billions in 1945, and the $3.75 billions loan to the United Kingdom in 1946. The remaining problems still proved too formidable for the Bank and Fund. The consequence has been the European recovery program of $14 billions, plus separate assistance for China, the Philippines, Greece and Turkey, Palestine, Children, Refugees, etc. In addition to these purely relief and recovery measures, there is Mutual Defense Aid for arms, and a proposal, made in the Gray report, for a program of economic assistance to European defense efforts.

The scale of the postwar recovery problem was thus underestimated at Bretton Woods. By June 30, 1950, it is estimated that United States expenditures since V-J day on foreign aid, including military aid, will have amounted to $42.5 billions.[4] Of this sum, only $6 billions represent contributions to UNRRA and subscriptions to the Bank and Fund.

The causes of this underestimation are many and varied. In part, there was no allowance for inflation or for the failure to achieve the international harmony on which original plans had been based. Mainly, however, the war-time planners failed to appreciate the seriousness of the structual maladjustments in the world economy. The physical damage ultimately to be realized was not underestimated; rather the contrary. What were misjudged were the changes which were to take place in relationships among income groups in Europe and between the countries of Europe and the rest of the world; the extent to which Europe in the light of these changes would be willing and able to limit consumption and investment to what it could produce itself without help from abroad; and the readiness of the United States, given this European incapacity and the threat posed by the aggressive designs of the Soviet Union, to offer the necessary help.

The experts of Bretton Woods were deceived in more than the scale of the problem. Its essential nature was not clearly foreseen. Preparation was made to cover a brief reconstruction period, mainly by loans of the Bank, and then to face the deep-seated problems of development on the one hand and of recurring trade dislocation on the other. The development problems were handed to the Bank. For the cyclical crises, the Fund's articles laid down certain rules: there was to be no competitive currency depreciation, no trade discrimination, except in rare cases, and borrowing as a matter of right within certain limits to enable countries whose exports had been cut off by depression abroad to go on buying imports.

Provision was made for a five-year period of transition which was to elapse before the rules took effect. Thereafter, however, the long-run problem of development and the cyclical problem of temporary dislocations were regarded as separate and distinct. This meant that temporary deficits and surpluses would be distributed about in random fashion. In

[4] See, "42½ Billion Spent on Aid since V-J Day," *New York Times*, October 23, 1950.

one depression the United States would have a surplus and the United Kingdom a deficit. In the next, the roles might well be reversed. No provision was made for the contingency that the business cycles were organically related to the deep-seated developmental forces, and that most cycles would operate in the same direction. If this were the case, the revolving fund set up to finance recurring depressions would always be required to operate in the same direction. Only one currency would be needed, that of the country originating or having the deeper depressions. And if the other countries had difficulty in prosperity in paying this currency back, the fund could be poured out but not revolved.

The assumption of a long-run equilibrium in international economic relationships from which short-run departures can take place in any direction for any country may be contrasted with the disequilibrium systems developed since the war. One of the most ingenious models of these, by the French economist J. Lévy-Jacquemin,[5] assumes that the countries of the model may be ranked in an order A, B, C, D, etc., in which A will normally have a surplus in its balance of payments with B, C, D, etc.; B a deficit with A, but a surplus with C, D, etc.; C a deficit with A and B, but a surplus with D, etc.; and so on. In these circumstances, any system which lends B, C, or D A's currency under the stress of a temporary disturbance will find itself frozen in short order. The possibility exists that devaluation and the Korean crisis have finally proved the correctness of the assumption on which the Fund was created. The writer has the temerity, however, to doubt it.

In the case of the Bank, where it was clearly seen that the principal currency loaned abroad would be dollars, the institution was organized with its principal officers of United States nationality, though the board was an international one. The assumption that each country is equally likely to be a borrower or a lender, and that over a long period of time a country will be a lender for approximately as long as it is a borrower, led to creating the Fund without the same measure of American leadership (domination) as the Bank. The United States subscription to the Fund was the largest of any country, since it was clear that if dollars were needed abroad because of depression in the United States, the sum required would be large. But the Fund was organized more nearly like a credit union than like a bank.

The credit-union principle is suitable when borrowers and creditors change roles from time to time or when there are clearly established principles for lending. When neither condition is met, it is important to

[5] J. Lévy-Jacquemin, *Grandeur ou Décadence du Plan Marshall*, Paris, Librairie Marcel Rivière, 1948.

establish authority and responsibility.[6] The United States has a large voice in the policy, but by no means a dominant one. For the most part dollars would be the currency sought by countries dealing with the Fund, but the rules laid down for their use became inapplicable when the basic assumptions of Bretton Woods went unrealized. In this circumstance, the international character of the Fund led to hesitation and indeed indecision.

III

Granted the failure of foresight at Bretton Woods, and rigid organization as well as policy, the question remains: how have the Fund and Bank fared? Whatever the hopes and promise of 1944, how have they succeeded in adapting themselves to the realities of 1946 and 1950? The answer differs for the two institutions. After several false starts, the Bank, with the easier task, is making a promising beginning on its task. The Fund remains a disappointment.

The original criticisms against the conception on which the Fund was established were two:[7] first, that it would be unable to function in the immediate postwar world, so that its early establishment would lead to the sidetracking of administrative and professional talent, the frustration of hopes, and political failure; second, that the notion of attempting to support each currency in terms of every other currency, on which the Fund was constructed, was misguided, and should be superseded by an approach aimed at stabilizing "key currencies." Other criticism came later, and was directed to the small amount of the foreign exchange which could be bought, in relation to potential balance-of-payments deficits, and to the validity of the objective of achieving a multilateral trading world of convertible currencies. In the beginning, however, the attack was directed primarily against timing and method.

These two matters are not distinct, but interrelated. This may be seen by starting with method. As in so many instances of policy decisions, where a pair of alternatives is long debated, the matter was resolved by undertaking both. Before the Fund could come into operation, the true

[6] This dictum has a wider application than to lending, but has to be qualified when the several parties to a problem are equally dependent on the solution. Producer and consumer countries working together on an international commodity agreement, for example, may have equal voices in the final agreement, since neither group can arrive at a satisfactory solution without the cooperation of the other. The same is not true in international lending, where the lender needs the borrower less than *vice versa*, or in international relief distribution. The arrangement whereby the United States contributed 72 percent of the aid in UNRRA and had 6 percent of the votes in its council was satisfactory to the extent that objective principles governed the distribution of relief, *i.e.*, to the extent that the voting was unimportant for this purpose.

[7] For a fuller discussion (and a longer list) see R. F. Mikesell, "The International Monetary Fund," *The Journal of Political Economy*, LVII, p. 395–412, especially n. 2.

dimensions of the British crisis, unseen in the war, became discernible. It was clear that the Fund could not cope with it. So much had been foreseen, indeed in the notion that the Fund should be reserved for post-transitional use. It had, moreover, been assumed that the transitional difficulties would be met with means such as discrimination, quotas, devaluation, etc., different from those of the Fund. In the event, however, the British loan which was negotiated in 1945 and took effect in 1946 embodied the key-currency approach rejected in 1944.

There are two ways to look at the British loan. On one showing it could be said to be a repudiation of the design of the Fund, and to sidetrack it. On a more generous interpretation, it was intended to make the Fund possible. The British loan would achieve convertibility; the Fund would maintain it. But the necessity for the Fund to stand idly by while the multilateral, convertible world was being achieved, as the early critics of timing had maintained would be the case, limited its chances for development.

The same was true in the case of the Marshall Plan, which was substituted for the British loan when the key-currency approach failed. This time, however, there were several differences. In the first place, the Organization for European Economic Cooperation, formed to draft the original recovery program, included provision (or rather strong hints) for stabilization-fund grants to the participating countries from the United States, just as if the Fund had not existed.[8] Secondly, as the program developed, the attempt was made to correct for the evils of inconvertibility in intra-European trade by establishing, with assistance from the United States, a limited system of clearing within the area. The problem is complex and cannot be developed here beyond the statement that it arose from an attempt of the European countries to earn dollars in European trade to pay for imports from the western hemisphere—an attempt in which one country might succeed but all were bound to fail and which dried up the interchange of goods within Europe. The solution to the problem was to create a system in which European countries would try to maintain a high level of trade in Europe without striving for large import surpluses because these are financed with dollars. A series of solutions and modifications has been adopted, with the Organization for European Economic Cooperation as the decision-maker and the Bank for International Settlements as agent of the clearing. In this important effort to achieve a limited regional convertibility, however, the Fund has not only been observer and critic, but an outsider.

[8] Organization for European Economic Cooperation, I, *General Report*, Paris, September 21, 1947, Chapter IV, especially paragraphs 72–77.

The other major postwar issue which the Fund was designed to settle was that of foreign-exchange rates. The resources of the Fund were assembled to eliminate the unsettling effects of exchange depreciation by enabling countries to borrow to finance temporary deficits. In addition, multiple-currency practices, under which countries had separate rates of exchange applying to separate commodities for export and import were to be eliminated in the interest of freeing the world market. Elaborate rules were devised at Bretton Woods to accomplish these objectives.

Certain exchange-rate cases in which international differences of view existed have been aired at the meetings of the Fund. The French devaluation of January 1948, led to the introduction of a system of multiple-exchange rates which the British deplored. The question was discussed at the Fund. The Fund protested. The practice was eventually modified. A number of smaller countries have discussed their exchange problems with the Fund and received advice in the direction of simplification of the system. But for the most part the Fund has exercised no leadership in the matter of exchange rates, and has been apprised of decisions after they have been made on a national basis. In the initial period of its operation, the Fund accepted notification of currency values without suggesting changes, and its chairman made a defense of overvalued rates.[9] The major postwar change, the devaluation of the pound sterling in September 1949, came after a meeting of the Board of Governors of the Fund and the Bank, but so shortly after as to represent action following notification to, but hardly with the active participation of, the Fund. Most recently, the Canadian dollar has been set free of any parity in direct contravention to the ideals of Bretton Woods.

In this area, to be sure, the Fund is a victim of an intellectual lag. In 1944, exchange depreciation was regarded by the economic profession as an abhorrent and unsettling device which pushed the burdens of economic adjustment on to other countries. By 1949, exchange depreciation was viewed not as a corrective for a business-cycle dislocation where it was unsettling, but as a desirable course of action to correct deep-seated disequilibria. The opinion of the profession had matured slowly in this regard, but the Fund with all its research, or perhaps because of it, was behind the march of economic and official opinion.

What, then, is the Fund doing as it waits for March 1, 1952, when the transition period comes to an end, and the multilateral, convertible world is to be ushered in? The Fund has undertaken certain financial trans-

[9] See Camille Gutt, "Exchange Rates and the International Monetary Fund," reprinted in *Foreign Economic Policy for the United States* (S. E. Harris, ed., Cambridge, Massachusetts, Harvard University Press, 1948), p. 217–235.

actions making its resources available to its member countries. It has rendered certain judgments and tried to establish certain principles affecting the price of gold. It has given advice to a number of seekers therefor, sending its personnel to conferences and missions as observers and participants. And it has undertaken a program or perhaps one should say two programs of research.

The Fund's loans, euphemistically called "currency sales" to members against the member's currency, have amounted to some $775 millions from the beginning of operations in 1947 to April 30, 1950. Of this amount, approximately $610 millions were sold in the year from July 1, 1947, to June 30, 1948. These were hardly liquidity loans, as envisaged at Bretton Woods, but rather long-term financing made on an emergency basis to maintain the economies of countries in Europe pending the European recovery plan. The needs of Europe were acute and the legislative progress of the Marshall Plan slow. It was recognized that the Fund's resources should have been safeguarded for use in short-term cyclical loans; the fateful crisis of 1947–48, however, required the scrapping of theory to the end of survival.

The major use of the Fund's resources has thus run contrary to design. Conversely, the sharp spurt in the United States export surplus from $1.3 billions in the third quarter of 1948 to $2 billions in the second quarter of 1949, as a result of inventory decumulation in the United States which cut imports[10] and an increase in foreign buying, which raised exports, was attended by inaction on the part of the Fund, although it was the type of cyclical disturbance for which the institution was created. The reasons for this passivity were manifold. In the first place, British purchases of dollars from the Fund against sterling in 1947–48 had been made to the limit of the British quota so that further sales could take place only at the rate of 25 percent of the quota, or $325 millions, during any twelve months. British reserves fell almost $600 millions from the end of March to September 18, 1949 (from $1,912 to $1,320 millions). Judged by the severity of the disturbance, the Fund had been established on an inadequate scale.

More important than the size of the Fund's resources was the fact that the nature of the dislocation was altogether misjudged, by the British authorities at least, and possibly by the Fund. The sudden drop in American purchases of raw materials in the spring of 1949 was taken as

[10] The impact of the decline in inventories on imports was greater than revealed by the over-all figures for the latter (which showed a decline from $2,735 millions to $2,346 millions over the relevant period), but was offset in considerable part by the rise in the price of coffee and in the value of coffee imports. This means that the pressure on the sterling area and Europe was greater, and that on Latin America less, than is revealed by the totals.

the herald of a full-scale American depression, in which long-term investment would melt away, rather than an adjustment in inventories. If a major depression had taken place in the United States, the British position would have been difficult indeed. As it was, the British regarded the decline in their already low reserves as critical. Foreign-exchange traders began systematically to sell the pound short, increasing sales of goods to the United Kingdom and postponing payment for exports. The pressure became unbearable. As a first step, the British authorities in August 1949, imposed sharply increased import restrictions and obtained parallel action by other members of the sterling area. These measures were taken in opposition to the long-run policies of the Fund, but were permitted under the transitional exception. The second action was to devalue the pound after notification to the Fund. India and Australia purchased dollars against their own currencies to the extent of some $50 millions, and the Fund sold roughly an equal amount to other countries (most of it going to Brazil). The 1949 inventory recession in the United States—a type of disturbance which the Fund was equipped with $8 billions (but only $3.5 billions in gold and United States dollars) to meet—corrected itself with the Fund selling a mere $100 millions to its members during the year.

The Fund's efforts to maintain the respectability of gold as an international monetary reserve involve a long and complex story not worth recounting in these pages. The main problem arose from the attempt of certain countries to escape the effects of the inflationary rise in costs of gold mining over the period of the war in the face of an unchanged price of gold for monetary purposes, at least prior to devaluation. The Fund ruled that sales of newly-mined gold outside of monetary circles, *i.e.*, to free markets where hoarders were willing to pay a premium for it, could not be countenanced; that certain types of subsidy to gold mines were acceptable but that others were not. The major dispute with the Union of South Africa evaporated after the devaluation of the pound which raised the internal and external price of gold in sterling. Prior to this happy solution, however, the Fund had indulged in a running debate, and had handed down a number of abstruse decisions which gained it no great reputation—nor, outside of South Africa, lost it any.

The main output of the Fund in fact has been research. In the realms of balance-of-payments estimates and monetary statistics, it has carried on and enlarged the work of the Economic and Financial Department of the League of Nations. Its monthly *International Financial Statistics* duplicates in a degree the United Nations' *Monthly Bulletin of Statistics*, but provides an indispensable source for many series. The Fund's statisticians, like those of other international agencies, serve to develop national data in collaboration with member governments, as well as to collect those already in existence. In addition to numbers, the Fund collects information on financial developments and assembles, collates and analyzes material on trade and exchange restrictions.

But the research of the Fund goes far beyond the collection and ordering of data. To a considerable degree it approaches pure research—some of it fairly closely related to policy questions faced by the Fund's members, but much of its many stages removed from the realities of international economics and finance. So important is research to its activities that in a recent reorganization some research activities were taken away from the research department and handed over to another expanding department. For a time, scientific papers by the staff were circulated privately among economists and statisticians. Recently, this arrangement has been regularized with the publication of a journal entitled *Staff Papers*, signed by the individual authors and on the level of an academic periodical.

It may be a somewhat delicate business for an academic economist to appear to criticize an institution for being academic. Certainly no one can gainsay the high quality of the Fund's research. If it were a by-product of a full and useful life, it would be clear gain. What is awkward, however, is the tendency for research to substitute vicariously for a role in the world of affairs with the *reclame* of publication serving to compensate the staff for its inaction and lack of responsibility.

The Fund serves as a reserve of high-grade academic talent available for temporary use. It may be drawn upon to staff missions or to man short-run operations. It further performs a useful function in training men fresh from graduate work who later go on into positions with more direct contact with problems and responsibilities. In these respects, the Fund's experience of a brief period runs parallel to that of a number of central banking institutions since 1929.

The question arises, however, as to the value of these services as compared to their cost. In general it is inappropriate to judge a governmental enterprise, on the national or international level, by the standard of whether its income covers its expenses. Nevertheless, the Fund is expensive, costing gross nearly $4 millions annually. In 1947–48, when it sold $600 millions of currencies, it made a profit on the basis of its service charges. At the later rate of $100 millions of sales annually, it has been running an annual loss of $1.8 millions a year.

The Fund has recently attempted to take a more positive position in international finance by handing down a ruling at the world trade conference at Torquay that the United Kingdom, Australia, New Zealand and Ceylon no longer had an exchange reason for maintaining their import restrictions of August 1949, against exports from the United States.[11] The reason was the improvement in sterling-area reserves. The British monetary authorities, however, appear unlikely to be ready to remove these restrictions on the grounds of the uncertainty of the future.

The suggestions of the five experts appointed by the Secretary-General of the United Nations to change the statutes and practices of the Fund to make it more useful are unlikely to achieve acceptance in the near future. These would require a country—say the United States, which is regarded as the most likely offender—to deposit its currency with the Fund whenever a depression lowered the value of its imports, by the amount by which imports fell short of the appropriate level. Other currencies would be enabled through purchases of this currency to continue buying United States exports as before. There would be no limit to the amount of dollars these countries could draw—in contrast with the quota system—although they are designed ultimately to be repaid. Conversely, there would be no limit to the obligation of the United States, which tends to make the proposal unattractive to the Congress of the United States.

The Fund then has emerged from the drawing boards of Bretton Woods into a world different from that in which it was expected to operate. The dimensions of the world are different for one thing, and the Fund's resources are not as large as originally contemplated. The world behaves in ways different from those in which it was assumed it would. Perhaps of greatest importance, the principles which were originally agreed upon at Bretton Woods no longer are accepted by a number of the countries which participated there and ratified its results. Britain, for example, is clearly ambivalent in its attitude to the principles of currency convertibility and trade multilateralism.

The Fund has not adapted itself in practice to the world as it found it. In the absence of leadership and principles, it was incapable of so doing. The question whether leadership could have been substituted for lack of agreement on principles must remain unanswered for lack of sufficient evidence.

It may be permissible to criticize the Fund for its failure to provide an adequate test of the proposition that leadership can provide a substitute for agreement on principle. Perhaps the test would have shown that it cannot and that no change in the structure or practice of the Fund will be possible until a new consensus on principles emerges in the world of international finance. In this event, however, the question arises whether

[11] See "World Fund Finds Sterling Is Safe," *New York Times,* November 4, 1950.

the Fund needs so large a staff, so well paid, to maintain an organization in being for eventual possible use.

IV

The history of the International Bank for Reconstruction and Development since Bretton Woods follows a rather different pattern. The amount of monies loaned by the Bank was of the same order of magnitude—$758 millions being outstanding on June 30, 1950, with commitments to lend $59 millions more. The bulk of these loans had been made in 1947, too, as an emergency accommodation to European countries in desperate need. The annual budget of expense of the Bank also runs approximately $4 millions. The institutions are housed in the same building, have some common directors, and a number of common facilities such as the library. But here the similarities end. The Bank is a creative, adaptive institution which is performing useful and interesting work.

This was not uniformly the case throughout its life. Three periods can be found in this brief history, not too clearly defined. In the initial or bureaucratic period, enormous effort was devoted to organization and to such vital matters as accommodation, recruitment, outfitting the officers' diningroom, etc. The nature of the Bank's administration incurred the enmity of the banking community in the United States. The result was that when the Washington direction of the Bank was replaced with that of New York, a considerable period of reorganization had to ensue before other than emergency operations could be undertaken.

The second period of the Bank's history under Wall Street management, saw the development of a long list of business principles, together with a phenomenal growth of public-relations activity. An impressive campaign was undertaken to familiarize the investment community with the bonds of the Bank, which were a source of lending power additional to the capital subscriptions of the members. More promotion went into the issuance of $250 millions of securities than into any comparable fund-raising in the history of American finance. Efforts to impress banks, savings banks and insurance companies with the soundness of these securities led to the establishment of strict standards of lending for reconstruction purposes, including an elaborate system of restricting loans to a project basis which the Bank carefully watched in their physical manifestation to ensure that funds were not misused.

In its extreme form, the project basis for loans involved concern for the capacity of the individual project on which a Bank's loan was to be based, regardless of the economy as a whole. If this steel mill, irrigation scheme or locomotive purchase could be demonstrated as likely to earn the foreign exchange to pay interest and amortization, the Bank was satisfied. In addition, the Bank was concerned to follow the materials purchased by its monies to ensure that they were used in the project and in no other fashion. The questions whether the over-all economic program of the country was likely to produce debt service for a project which earned no foreign exchange directly, or whether other similar materials not being financed by the Bank were being used economically, were ignored.

During this period the Bank insisted that the reason for its slowness in lending to underdeveloped countries was that there were not enough suitable projects. It clung to all the restrictive language in its articles of agreement—such as the statement that loans should normally be limited to the foreign exchange value of a project. At the same time it rejected the broader purposes laid down at Bretton Woods—such as the stipulation that its loans should be so timed as to iron out business-cycle fluctuations in the world economy. The watchword of the period was caution.

The current phase in the Bank's development is difficult to demarcate neatly from the second in time; but it is characterized by a different attitude. The Bank refunded a portion of its original $250 millions borrowing on a competitive bidding basis, which the majority of the investment community deplores, and occasioned a considerable loss to the successful underwriter, who bid above the market. This episode the Bank characterizes as successful (it did cut its interest charges), although there was a question for a while whether it might not prove to have slowed down the public acceptance of the Bank's obligations. The major change, however, was in the Bank's attitude toward its debtors. It took seriously the criticisms of the project basis for loans, the restriction of loans to foreign exchange content of the project, and of the tied-loan nature of its loans.

The project's base for loans has been explained. The limitation of loans to the foreign-exchange content of projects meant that any import surplus created by domestic expenditure associated with the project could not be financed by loans. A tied loan is one which, like those of the Export-Import Bank, must be spent in the country and currency in which it is borrowed. The Bank's loans are not exactly of this type, but its practice was to lend the borrower the currency it intended to spend rather than to lend in the cheapest currency and allow the borrower to spend in the cheapest market for the product. This latter practice would have been a more truly multilateral basis.[12]

[12] For a detailed statement of these criticisms, see my *The Dollar Shortage*, New York, Technology Press and John Wiley and Sons, 1950, Chapter IV.

In a long and detailed statement of its lending policies in its fifth Annual Report for 1949–50, the Bank, under the guise of defending these policies, fundamentally modified them in the directions indicated by the criticism. None of these changes, it should be noted, ran contrary to the letter of Bretton Woods, but many represented wide departures from the spirit in which the articles were drafted, substituting, for example, the exception as the basis of practice in place of the rule.

The most important change, however, went far deeper than response to adverse criticism. The Bank itself became an innovator and experimenter. It undertook a number of pioneering studies in the development of underdeveloped countries. It responded to what it found by devising new types of loans—far removed from the project basis—to see how to make maximum progress in economic development. One loan, for example, to the Industrial Development Bank of Turkey, is really to encourage the expansion of an entrepreneurial class in that country. The Bank has learned in two or three years that large piles of structural steel and concrete are inadequate stimuli to development in the absence of a leadership group, whether of business men or civil servants. This lesson carries it well beyond Bretton Woods.

In 1947 the Bank loaned approximately $500 millions to European countries for emergency purposes. In 1948, the rate of lending sank to $28 millions for the year. Since that time the Bank has not hesitated to make use of its resources. Loan commitments have risen to $125 millions, $88 millions, and $79 millions, respectively in the first and second halves of 1949 and the first half of 1950. The number of loans seems to be increasing and their average size decreasing. The resources of the Bank are unlikely to be large enough to accomplish the task of economic development of the underdeveloped parts of the world unassisted. The experimental approach finally adopted appears to represent an attempt to get the maximum leverage possible with the resources available.

The real question which may be raised for the Bank is whether its operations are on a large enough scale to meet the problem. The United Nations experts want to have international long-term lending fixed at a high level, in which the International Bank, with the aid of a new department operating with new criteria, contracts to find investment outlets for all the capital scheduled to be loaned in a given year which it is expected that private investors will not place. These loans would be made not on specific undertakings but on general developmental programs, judged in terms of their total effect on national income, taxable capacity and export capacity.

While it is clearly from such experience as that in the Philippines that large-scale handouts without adequate criteria for lending are likely to lead to disaster,[13] there is reason to worry over the pace at which the International Bank is lending and preparing to lend. The member countries originally made two percent of their capital subscription available in gold. Eighteen percent more was subject to call; the remaining 80 percent is subject to call by the Bank only to meet defaults of the Bank on its borrowing. The eighteen percent of the United States subscription was paid in 1947. Of this, calls on other members and $250 millions of borrowing, only $267.5 millions remained available for new loans on June 30, 1950.[14] Unless the Bank undertakes further borrowing in the New York market, it will be unable to increase the scale of its loans to any considerable extent, although it could go forward for one and one-half years at the existing rate.

The unsatisfactory character of the present rate of $150 millions annually is underlined in the Gray report. This asserts that it is the policy of the United States to place primary reliance for public development loans on the International Bank, that the appropriate rate of lending for the next few years in this category should be $600 to $800 millions annually, and that the Bank should account for $400 millions of this, leaving $200 to $400 millions for the Export-Import Bank.[15] If the Bank is to attempt to operate on this scale, it will have to make an early and large approach to the investment market for funds. While its first issue of bonds is selling on a premium basis, a number of observers are sceptical whether the market will respond favorably to a large, new issue, especially if it is to be one of a forthcoming large series.

The Bank then has its problems which must be solved before it will be able to claim to be filling the role it was designed to play. Yet it may be said that at last the Bank is productively devising the techniques necessary to do the job in international developmental lending laid down at Bretton Woods.

V

It has been suggested that the comparison between the dormancy of the Fund and the activity of the Bank is unfair. The task of the latter was far easier. Once it was recognized that the problem of postwar reconstruction was too large for the Bank, its task narrowed down to economic development. The objective was clear. The problem was to devise means. After a doctrinaire start, the institution, under alert leadership, shifted to an empirical approach.

[13] See Economic Survey Mission to the Philippines, *Report to the President of the United States*, Washington, D. C., October 9, 1950.

[14] International Bank, *Fifth Annual Report*, p. 39.

[15] *Report to the President on Foreign Economic Policies*, cited above, p. 65–66.

No such possibility existed for the Fund. Agreement on the objective of a multilateral, convertible world could be given during the war, whether under pressure from the United States or not, without really being carefully weighed. Misgivings could be stifled on the grounds that the date of performance lay far in the future. The organization and launching of the Fund could proceed equally well without fundamental agreement on the underlying principle of convertibility and multilateralism because the period of exemption covered by the transition stretched ahead for five years. The Fund represented an aggregation of interests without cohesion of purpose or clear leadership. It is small wonder that it has not made more headway.

The moral for international organization is by no means obvious. Should one create organizations like the Fund, ITO, ECAFE, the Council of Europe, etc., to operate in an area where problems exist but where there are neither agreed principles nor strong leadership? Lip-service to high principle is not enough if basically there is a reluctance to reshape national conduct. It may be worth while to establish organizations in these areas in the hope that they may either lead in the reaching of agreements or continue to exist until agreements can be separately achieved, to save time in putting ultimately agreed principles into operation. On the other hand, their establishment and gradual decay may harm the cause of developing workable international institutions.

In those cases where organizations exist but are unable to perform useful work because of basic disagreement over the principles on which they should operate, it is almost equally difficult to be constructive. If agreement is unlikely in the future, there is much to be said for liquidation. Too frequently international organizations, like committees and old soldiers, never die. If, on the other hand, agreement in the future is likely or even possible, on the existing or a modified basis, there may be merit in maintaining a cadre. But in these circumstances, its manning table must be kept low, and its morale, if possible, high.