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THE BRETTON WOODS INSTITUTIONS IN TRANSITION

KLAUS KNORR

I.

The Bretton Woods institutions were set up long before physical warfare ceased. They are part of a wider undertaking to further international cooperation in the postwar world. Befitting its imposing influence, the United States took a prominent part in this enterprise. The overall design lending coherence to the blueprints for economic collaboration is predominantly of American authorship. It is too early yet to assess the worth of these blueprints and the merits of American policy, but even now it is clear that some of the new institutions may not function as intended. Adverse and unforeseen circumstances may force either drastic revision or failure. According to some observers, the companion agencies established at Bretton Woods belong in this category.

As the charters of the International Monetary Fund and the International Bank for Reconstruction and Development bear the imprint of official American thinking, so their policies are subject to decisive American influence. State Department plans for a new world economic order began to assume articulate shape as early as 1943. Their immediate objective was to resurrect a viable system of multilateral trade based on relatively stable and interchangeable currencies, moderate trade barriers, non-discriminatory trade practices, and a healthy flow of investment capital, — all conditions that had been rapidly vanishing during the 1930's. Among their ultimate aims, American spokesmen stressed, first, that such a regime would promote world prosperity — as indeed it might, if it worked — and, secondly, that non-discrimination coupled with rising world prosperity would enhance the prospects of peace, which is a more vulnerable assumption. A third American objective is less explicitly avowed though no doubt of major importance. Multilateral commerce is eminently suited to the American system of government and economic organization. Prewar trade practices were not, and their continuation would either harm American trade or compel further extensions of governmental controls over private business.

This basic orientation of American policy descends directly from the

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pre-war policies of Secretary of State Cordell Hull,[1] but with the exception of the Reciprocal Trade Agreements Act, the means devised are new and bold. They chiefly comprise the Fund, the Bank, and an International Trade Charter and Organization. This institutional triad is boldly conceived because it proposes a measure of close international cooperation sharply contrasting with prewar history and never before achieved. But it can be questioned whether this boldness does not, in several aspects, border on the utopian in that it disregards or minimizes unfavorable conditions. Among the unpropitious circumstances which American planners did not and perhaps could not correctly forecast are the dangerous rift in world politics, the immense impoverishment bequeathed by the war, the accelerated trend toward more governmental planning in economic affairs, and the preoccupation of most industrial societies with the need of full employment at all times. The first of these circumstances limits global cooperation in the economic field while the other three conditions either make revived multilateral trade a goal of something less than overriding concern to most nations or else render its implementation more difficult.

The impact of these adversities is reflected in the tortuous deliberations on the ITO which were started only after the end of the war and are not yet completed. They are manifest not only in the slowness of the deliberative process but also in the many compromises and changes inflicted on the original American proposals. Numerous qualifications and escape clauses have whittled down the substance of non-discriminatory multilateralism. To insure wide international adherence, these concessions were necessary even though the United States commanded a strong bargaining position and could and did use blandishment and pressure in support of persuasion.

The Fund and the Bank were launched much earlier than the ITO. American, British and Canadian projects for monetary cooperation were published in 1943.[2] With an intimacy of collaborative effort not, unfortunately, repeated on subsequent occasions, the United States and Britain formulated a joint proposal which was far closer to the White than to the Keynes Plan. This proposal as well as the scheme for a world bank was adopted by the Bretton Woods Conference in July 1944 and the agreements became effective in December 1945. Subsequent accessions have increased the membership to 45 nations.

A comparison of the Bank and Fund reveals several similarities. They

[1] H. J. Tasca, *The Reciprocal Trade Policy of the United States*, (Philadelphia, 1938).

[2] American proposals (the White Plan) are contained in *Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations* (Washington, July 10, 1943). British proposals (the Keynes Plan) appear in *Proposals for an International Clearing Union*, Cmd. 6437 (London, April 7, 1943); Canadian proposals in *Tentative Draft Proposals of Canadian Experts for an International Exchange Union* (Ottawa, June 9, 1943).

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are separate institutions but were created as twin agencies and have identical membership. Their organizational structure is the same. Each agency has a Board of Governors, Executive Directors, and a Managing Director. All powers are vested in the Board of Governors who are appointed, one each, by the member countries. The Boards, which meet only periodically, delegate specific powers to the Executive Directors who are responsible for the conduct of general operations. The United States, the United Kingdom, China, France, India, and — if it joins the agencies, the Soviet Union — are entitled to permanent representation. Two Executive Directors are elected by the American republics, the remaining five by the other members. The Executive Directors select a Managing Director (called President in the case of the Bank) who is ex-officio chairman of the Directors, heads the operating staff, and conducts the ordinary business of the agency.

The two institutions follow the same basic procedure for policy-making. Decisions will be made by a simple majority of the votes in most, and by a qualified majority in other, cases. The egalitarianism of one-country-one-vote has been discarded since there are wide differences in the financial help which a member country will give or receive through these agencies. Bank members are assigned subscriptions and Fund members are given quotas, both expressed in dollars which — among other things — determine the number of votes to which each country is entitled. Individual quotas and subscriptions were arrived at by computing an index of certain relevant economic data (national income, trade-balance fluctuations, gold holdings, etc.) and by prestige considerations. The hierarchy of Bank subscriptions and Fund quotas is roughly similar. Selected member quotas at the top and bottom are shown in the accompanying tabulation.

Country	*Bank Subscription* (*millions*)	*Fund Quota* (*millions*)
United States	$3,175	$2,750
United Kingdom	1,300	1,300
(Soviet Russia)	(1,200)	(1,200)
China	600	550
France	525	450
Iraq	6	8
Ethiopia	3	6
Iceland	1	1
Panama	.2	.5

Each member has 250 votes plus one vote for each $100,000 of its subscription (or quota). On this basis, the United States controls 24.23 per cent of the Bank vote, Britain 14.17 per cent, China 6.68 per cent, and

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France 5.88 per cent. All Latin American members together have 8.38 per cent. The smallest national votes, representing 28 per cent each, are exercised by El Salvador, Honduras, Iceland, and Nicaragua. The distribution of votes in the Fund follows a similar pattern.

Both the Fund and the Bank are designed to help sustain an expanding world economy. The success with which the one discharges its specific functions will influence the accomplishments of the other. The effectiveness of both will depend upon the conditions which will prevail over a considerable period of time in world economy. They can gain from mutual cooperation. But the specific purposes and powers of the two institutions are entirely different and must be considered separately.

II. The International Monetary Fund

Purpose

Before the war, multilateral trade had been waning. When the international gold standard collapsed, there was no alternative monetary order to take its place. During the 1930's, foreign-exchange control, multiple exchange rates, blocked balances, competitive depreciation, bilateral clearing and disturbing capital flights characterized monetary affairs. Determined unilaterally and often ill-considered, these practices set in motion a vicious circle of defensive actions and caused trade and capital movements to lag and seek artificial channels. The purpose of the Fund is to prevent a return to such disorder. It is to facilitate the revival of multilateral trade, the principal requisite of which is the free interconvertibility of currencies for trading purposes. Traders must be able to sell exports in one market and spend freely the proceeds in another. This condition precludes foreign-exchange control (except on capital movements) and, with it, the trade-restricting effects of bilateral clearances and blocked balances. Also, trade as well as foreign investment is encouraged by relatively stable ratios of exchange, since unstable rates augment the costs and risks of international transactions and evoke erratic and perverse capital movements.

To promote thriving commerce, however, exchange rates should not be stabilized by foreign-exchange control, manipulation of import restrictions, or by varying domestic levels of production and employment. Exchange control obviously interferes with the interchangeability of currencies. Import barriers interfere directly with trade. Exchange stability via deflationary or inflationary adaptations of national economies was the prescription of the gold standard and is the main reason why that standard fell into disrepute and has no chance of re-instatement. Under modern conditions of cost-price rigidity, this adjustment mechanism requires toleration of large-scale unemployment. Today no international monetary system will prove acceptable if it sacrifices internal

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stability for the sake of stable exchanges. It is this set of desiderata which the Fund charter attempts to meet.

Policies

The Fund provides for free currency convertibility. Member countries are not to maintain foreign-exchange control on current transactions [3] except during the postwar transition period and on dealings in a specific currency which has been declared ''scarce'' by the Fund. Control over capital movements is permitted and, indeed, encouraged in order to choke off unsettling movements of ''hot money''.

Stable, though not rigid, exchange rates will be maintained. Each member undertakes to declare the par value of its currency in terms of gold or American dollars and to collaborate with the Fund in promoting exchange stability. Success in this undertaking depends on the availability of corrective means when a member's balance of payments shows a deficit on current account and its exchange rate, therefore, is under pressure. While the country is, of course, expected to meet the deficit by releases from its reserves of gold and foreign exchange, such operations are limited by the magnitude of the reserves. The Fund lays down two procedures for meeting an harassing deficit.

The member can apply to the Fund for additional means of international liquidity. The Fund has received from its members subscriptions equal to their individual quotas. Each member has undertaken to pay in gold or dollars either one-fourth of its quota or 10 per cent of its net holdings of gold and United States dollars, whichever amount was the smaller. The rest of the quota was paid in the member's currency. Thus the Fund possesses a pool of gold and foreign exchange totalling nearly $9 billion. If a member experiences an adverse balance of payments and a substantial drain on its reserves, it is entitled to draw from the Fund, against payment of an equivalent amount in its own currency, additional foreign purchasing power up to 25 per cent of its quota per year, as long as the Fund's holdings of the member's currency does not exceed 200 per cent of its quota. This access to reserves should be of inestimable value to countries that must cope with a temporary maladjustment in their foreign balances. Once their position improves these countries must begin to return the borrowed gold or foreign exchange. A rising scale of charges on borrowed funds is expected to encourage speedy repayment and discourage unnecessary drawings from the pool.

These drawing facilities will not, however, prove adequate when a member faces a persistent pressure on its exchange rate, possibly be-

[3] Current transactions comprise all international transactions other than transfers of gold and capital funds.

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cause that rate is overvalued. In that event, the Fund may allow such exchange rates to be altered. To correct a "fundamental disequilibrium" a member may propose such a change to the Fund. Depreciation tends to make a country's exports cheaper in terms of foreign currencies, thus stimulating exports, and its imports dearer in terms of the home currency, thus discouraging imports. To a change in exchange rates not exceeding 10 per cent of the initial par value the Fund must not object. For a more drastic depreciation the Fund's approval is required. Only if the proposed change is, in the Fund's judgment, necessary to correct a fundamental disequilibrium, shall it concur therein. The charter thereby furnishes an orderly method for maintaining a flexible stability of exchange rates.

Contrary to the gold standard, the new adjustment mechanism does not call for the removal of balance-of-payments deficits by forcing reduced imports through a forced fall in national employment and income. In judging whether a member's external accounts suffer from a "fundamental disequilibrium," the Fund is explicitly enjoined not to criticize "the domestic or political policies" of the country concerned. The Fund may not deny the corrective remedy because a member fails to protect its exchange rates by relaxing full-employment policies. On the one hand, the compromise solution of the Fund rejects exchange-rate rigidity which can be had only at the equally repugnant expense of domestic instability or foreign-exchange control. On the other hand, the Fund averts continually fluctuating exchange rates by allowing an orderly revision of rates from time to time.

The Fund has erected a third defense against the recurrence of monetary chaos. If an important trading country undergoes a depression, its imports contract and its currency will tend to become internationally scarce unless other countries quickly succumb to the deflationary impulse received from abroad. If they do not do so and if the depressed nation does not relieve the scarcity by extra capital exports, then many countries will encounter serious balance-of-payments difficulties simultaneously. Widespread disequilibrium will prevail. In that event, the Fund's holdings of the scarce currency and gold would hardly be large enough to grant all requests for loans. The Fund is then authorized to issue a report setting forth the causes of the scarcity and recommending corrective measures; to replenish its holdings of the scarce currency by borrowings from the scarce-currency country; and as a final step to declare the currency officially scarce. This declaration permits any member country, after consultation with the Fund, to regiment operations in the scarce currency. The introduction of such discriminatory controls against the scarce-currency country would tend to restore equilibrium by decreasing the exports of the depressed nation.

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Exchange dealings in other currencies would remain free. In effect, this provision means a cooperative, partial, and temporary suspension of multilateralism for the purpose of preventing its disorderly, complete and possibly permanent collapse.

Problems

Even at the inception of the Fund, it was clear that it could not be expected to function satisfactorily unless many inevitable problems were solved. There is a rapidly growing literature discussing the technical problems.[4] The following are among the important ones.

The Fund relies on the depreciation of exchange rates for remedying fundamental disequilibria in a member's external accounts. Yet depreciation will not always work without fail. It will increase the nation's receipts of foreign currency, relative to its payments, only if the world demand for its exports and its home demand for imports are markedly responsive to the price changes brought about by depreciation. To be sure, such elasticity is likely to prevail in most cases. What is less probable is that exchange depreciation will have its desired effect quickly enough. However, the danger of a delayed reaction is now minimized by a provision in the projected ITO charter which permits member countries to safeguard their balances of payments by a temporary resort to quantitative import restrictions. Thus, a country confronted with a fundamental disequilibrium can immediately reduce its imports while awaiting the effects of depreciation.

There is little in the charter to guide the Fund in finding and declaring a currency scarce. Timing is likely to be of the essence in remedial action. How many countries must have been affected and how intensely must they be under pressure before the Fund proceeds to the series of steps indicated? Above all, it is not at all certain, in the event of depression in a major industrial country, that selective import control can do more than mitigate its ill effects abroad. The danger, then, is that restrictions will mushroom all around.

The Fund started with the burden of determining initial par values for the currencies of members. To settle values that could be considered reasonably normal was, of course, an impossible undertaking at the time when, in the wake of war, trade relationships were abnormal and many national economies in the grip of inflation. In September 1946, the Fund

[4] For some excellent analyses see: Gottfried Haberler, "Currency Depreciation and the International Monetary Fund," *The Review of Economic Statistics,* v. 26 (1944), pp. 178-181, 191-193; J. P. Young, "Exchange Rate Determination," *The American Economic Review,* XXXVII (1947) pp. 589-603; Arthur I. Bloomfield, "Foreign Economic Rate Theory and Practice," in Seymour E. Harris (ed.), *The New Economics* (New York, 1947) pp. 293-314; Lloyd A. Metzler et als., *International Monetary Policies,* Postwar Economic Studies 7, Board of Governors of the Federal Reserve System (Washington, 1947); George N. Halm, *International Monetary Cooperation* (Chapel Hill, 1945).

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actually requested all members to report their current exchange rates and, in December 1946, decided to accept most of the rates as reported. M. Camille Gutt, the Managing Director, in his First Annual Report, conceded that "in some cases the initial par values that are established may later be found incompatible with the maintenance of a balanced international payments position at a high level of domestic economic activity," that — upon the return to less abnormal conditions — the Fund would "be faced with new problems of adjustment" and would "have to recognize the unusual circumstances under which the initial par values were determined. . . ." In other words, the Fund wisely postponed the initial determination of equilibrium rates of exchange.

Determining equilibrium rates will prove the most troublesome of all problems. So many variables are involved in the making of an equilibrium rate — most of them defying precise measurement or forecasting — that economists are unable to furnish criteria which is operationally useful. The Fund charter contains no definition of "fundamental disequilibrium," an omission that would have to be considered wise, had it not been inevitable. The Fund authorities will no doubt pay close heed to the gains or losses sustained by a country's reserves of foreign purchasing power. Yet this criterion is not sufficient, for the absence of any marked changes is quite compatible with depressed employment levels. Despite the difficulty of calculating equilibrium rates, the Fund must make cautious use of the trial-and-error technique of finding proper rates, for frequent changes will disturb commercial relations and capital flows. This is a real dilemma because smooth Fund operations will depend largely on avoiding frequent and persistent disequilibria. Enduring unbalance would distort the Fund's pool of member currencies and quickly diminish its usefulness as a stabilizing device.

These examples illustrate the complexity of problems which may bedevil the Fund. The lack of precise criteria and the compromises required by the divergent interests of potential soft— and hard — currency countries have resulted in a charter containing vague instructions regarding many policy problems and giving the Fund authorities wide discretionary powers. Much depends, therefore, on the wisdom with which these powers are exercised. Given the sharply graduated influence on policy-making, the behavior of the United States and Britain will be decisive. Between themselves, they possess about half the votes, and, owing to their preeminence in world trade, finance, and politics, they will always be able to "line up" other votes behind their respective policies. The Fund can be expected to operate with success if these two key nations collaborate closely, stabilize their economies at high levels of employment, and keep their own external accounts balanced. Yet it is by no means certain that these conditions will obtain. The international

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position of the two nations in world trade and finance is, today, greatly at variance. The United States is the principal proponent of relatively free enterprise and trade. It has gone less far than other industrial countries in insuring the stability of its economy while its capacity to disturb business stability abroad is unexampled. It is the creditor country par excellence. Its currency is the most likely to be scarce and this for reasons, in large part, originating in its own actions.[5] Britain, on the other hand, is the proponent of a "mixed" economy. It is prepared to judge discriminatory trade policies on the merits of specific practices. It is determined to combat depression. It is the world's debtor country and its currency is unlikely to become generally scarce. Viewing the entire group of members, there are other issues involving possible divisions of interest between relatively undeveloped and economically mature nations, between countries more or less dependent on world trade, between nations predominantly exporting raw materials or manufactured articles, between countries relying more or less on state trading, etc. In various ways, political tensions may affect cooperation in the Fund and lines of political division may cut across divergent economic or financial interests.

There are several specific issues that may divide the member countries and cause delays, inconsistencies, and unfortunate decisions in Fund operations. Countries anticipating a weak balance-of-payments position will tend to apply for an increase in their quotas which set the amount of assistance they can request from the Fund. Countries occupying a strong financial position may be inclined to oppose such requests and may be able to deny them since a four-fifths majority of the votes is required for quota revisions. In effect, this accords an absolute veto power to the United States. Majority approval of the depreciation of an important currency may not be easy to obtain since the applying country may be suspected of aiming at an unfair competitive advantage for its export industries,[6] while a scarce-currency country cannot be expected to support eagerly the invoking of the scarce-currency clause which might lead to widespread controls over dealings in its currency and cut its exports. Conflicts might arise over terminating the postwar transition period. The charter states that five years after the Fund begins operations, and in each year thereafter, any member still retaining exchange controls on current-account transactions, shall consult the Fund on their further retention. If it deems such action necessary "in exceptional circumstances," the Fund may recommend the abandonment of such restrictions and, if the member ignores this recommenda-

[5] See *The United States in the World Economy,* United States Dept. of Commerce, Bureau of Foreign and Domestic Commerce, Economic Series 23 (Washington, 1943).

[6] Jacob Viner, "Two Plans for International Monetary Stabilization," *Yale Review* (1943), p. 94.

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tion, declare it ineligible to use the Fund's resources. World economic recovery now appears to proceed much more slowly than was foreseen by the Bretton Woods planners. The transition period may be unduly protracted and, with it, the widespread employment of restrictive devices. The United States, however, is disposed to be impatient over the continued use of transitional controls and can be expected to press for early and, possibly, premature removal.

Record

On March 1, 1947, the Fund began operations and reported its acceptance of the currency par values proposed by 30 members. Owing to highly disorganized economic and financial conditions, the Fund agreed to postpone the fixing of parities for 8 members, including China, Brazil, Italy, Greece, Poland, and Yugoslavia. Eight countries have joined the Fund, bringing its membership to forty-five. Great Britain, France, the Netherlands, Mexico, and Denmark have been allowed to draw about 280 million dollars from the Fund. Except for £1.5 million to the Netherlands, all loans were made in American dollars.

Ambiguities in the Fund's statutes led to two important requests for official interpretation by the Fund authorities. The United Kingdom inquired whether it could depreciate its currency, without objection by the Fund, if it considered such action necessary to preserving full employment while its balance-of-payments position would be strained. The Executive Directors ruled that there could be no such objection provided the step was required to correct a "fundamental disequilibrium" and that the Fund reserved the right to state whether this condition actually prevailed. Allaying an American fear, the Directors ruled that access to the Fund's resources was definitely denied for purposes of financing relief, reconstruction, armaments, or large outflows of capital.

III. The International Bank

Purpose

The specific purpose of the Bank is to aid in the rehabilitation of war-weakened nations and in the development of relatively backward economies. The Bank is also designed to join the Fund and the ITO in providing a sound world economic environment. The Bank should "promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments . . ." (Article I of its Articles of Agreement).

Except for a few isolated and minor transactions, international flows of long-term capital before the war resulted from the uncoordinated decisions of private and, to a lesser extent, public investors. The record

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of these capital movements has not been a satisfactory one. Since private investment depends upon profit expectations and since profit expectations are governed chiefly by the fluctuations of the business cycle, international capital flows were highly unstable and accentuated the cyclical instability of merchandise and service transactions. This disturbed the economies in need of and geared to sustained inflows of foreign funds and contributed to disorganized balance-of-payments conditions after 1930. Not only was foreign lending erratic, there also was a notable trend indicating its secular contraction. With the Great Depression, long-term investments by private capitalists rapidly fell in volume and, eventually, shrank to a mere trickle. This decline was in response to obstacles originating both in the capital-exporting and in the capital-importing countries.[7] The breakdown of multilateral trade and free currency convertibility coupled with deteriorating debtor morality increasingly deterred private investments abroad.

It became clear during the war years that the postwar world would feel a keen need for capital to speed reconstruction and economic development. It was also clear that a spontaneous renewal of private foreign investment on a substantial scale could not be expected. Public investment might be forthcoming in large volume and would be welcome. But would it be enough? And could it meet all types of capital requirements? Government loans are often given for political reasons which the foreign debtor does not cherish. Nor can government loans be a satisfactory substitute for private loans between countries adhering to a system of comparatively free enterprise.

What was needed, in retrospect of prewar history and in anticipation of postwar conditions, was international cooperation toward insuring a steady and ample stream of funds, private as well as public. The Bank was created to meet part of this overall need. Its chief function was to stimulate private foreign investments by means of guarantees and participation; its second function was to supplement the private capital market by financing worthy projects for which private funds could not be found on reasonable terms.

Policies

Composed of subscriptions of its forty-five members, the Bank had, in November 1947, a nominal capital totalling $8,225 million.

Only one-fifth of this sum, however, is subject to immediate call. At the start of operations, the members began to pay two per cent of their subscriptions in gold or United States dollars and the remaining 18 percent in their own currencies. Four-fifths of the subscribed capital represents a reserve guaranteeing the Bank's operations and will not be

[7] League of Nations, *Conditions of Private Investment* (Princeton, 1946).

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called up until needed for this purpose. The Bank is designed to engage in three different types of lending activities. It may guarantee, in whole or part, loans issued through the ordinary channels of private investment markets if, on account of the risks involved, a loan would be floated only on terms which the borrowing country could not afford to accept. Next, the Bank may give loans out of funds it acquired through the sale of its own debentures in private investment markets. Finally, the Bank can make direct loans out of its own paid-in and earned capital.

The international character of the new institution is most conspicuous in its provisions for guarantees. Even at the time the Bank was set up it was clear that few countries would have investible surpluses in the postwar period and that, in fact, the United States would by all odds be the major source of funds. Yet while only a few favored countries may be able to supply capital, it is the novelty of the Bank arrangement that these countries need not assume the entire risk involved. The risk burden is distributed internationally since all guarantees will be joint and several up to the limit of each member's subscription.

Indeed, the Bank's guarantees and bonds are backed by a veritable gamut of precautionary arrangements. The Bank will only consider transactions after a thorough inquiry and approval by a committee of experts, and except in special circumstances, loans or guarantees will be granted only for specific projects of reconstruction or development. The Bank will help only if interest rates and other charges are reasonably low and if there are good prospects that the borrower will be able to meet its obligations. The Bank will make arrangements to insure that the proceeds of any loan are spent only for the purpose for which the funds were advanced, and the borrowing country must fully guarantee the repayment of principal and the payment of interest. This guarantee, redeemable in gold or free foreign exchange, is less likely to prove an insupportable liability because it covers only the annual servicing of the loan and, hence, will be spread over a long period of time.

To lessen monetary obstacles in the way of servicing loans, Bank membership is contingent on membership in the International Monetary Fund. The Bank itself is a guarantor; its outstanding loans and guarantees will not be permitted to exceed its unimpaired subscribed capital plus accumulated earnings, while if the Bank's contribution is the form of a guarantee only, it must secure the consent of the member in whose capital market the funds are to be raised and of the country (should it not be the same) in whose currency the loan is to be granted. If the Bank considers a direct loan, it can act at its own discretion up to the two per cent of its total subscription that has been paid in dollars and gold. Direct loans made out of the remaining 18 per cent of the Bank's paid-in subscriptions require the consent of the member in whose cur-

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rency the loan would be given. Thus, the lending countries exercise a special veto over most lending transactions of the Bank. This mesh of safeguards should result in low risk premiums which, in turn, would serve to make defaults less likely than under conditions of risk premiums computed on a commercial basis.

There are four further provisions deserving notice. In extending or guaranteeing loans, the Bank is entitled to a suitable compensation (one per cent per annum) for its risk. The Bank must not require that the proceeds of a loan will be spent in the territories of any particular member or members. The loans, in other words, are not "tied" and thus will reinforce multilateral trading. All ordinary matters of the Bank are decided by an unqualified majority of the votes. Finally, the Bank is forbidden to let any other than economic considerations influence its decisions. According to Article IV, "the Bank and its officers should not interfere in the political affairs of any member; nor should they be influenced in their decisions by the political character of the member or members concerned."

Problems

Like the Fund, the Bank is confronted with basic problems that can be only tentatively appraised at this time. In the near future, few countries will be able to afford even limited capital exports. This will not only militate against widespread flotations of Bank debentures, it will also restrict the volume of direct loans which the Bank may be called upon to undertake, for most member countries will prove chary of consenting to loans made out of the 18 per cent of their subscriptions which they paid in their own currencies. During the immediate postwar period, therefore, the Bank will depend heavily on the private capital market of the United States. How much this market will yield is entirely conjectural. It should depend primarily on the attitude of investors toward foreign ventures, the reputation of the Bank, and on the attractiveness of the interest rates.

The Bank's appeal to private capitalists will be determined chiefly by the soundness of the Bank's loans. The series of safeguards provided for does by no means eliminate risk.[8] Thus, borrowers which have received loans through the Bank, may subsequently incur other debts excessive in terms of the borrowing country's transfer capacity. Even if regarded as perfectly sound when negotiated, lending transactions may turn out to be unsound unless multilateral trade flourishes and permits debtor nations to acquire ample foreign exchange. Similar considerations may apply to the quality of the members' subscriptions on call for guarantee

[8] Henry C. Wallich, "Financing the International Bank," *Harvard Business Review*, v. 24 (1945-46), pp. 174-179.

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purposes. The American investor may well be disposed to rely only on the soundness of American guarantees. This would slow down Bank loans once its total commitments exceeded $2.5 billion.

On the one hand, the Bank is supposed to consider only applications for loans which, without its backing, could not be placed on reasonable terms. On the other hand, the Bank is explicitly instructed to be very prudent in its operations. To be sure, there is a demand for foreign investment in types of worthy enterprises which have never appealed to the private investor and, besides, interlocking guarantees permit the Bank to assume greater than ordinary risks. Nevertheless, as a British observer queried, "how many loans are there likely to be which are safe enough to meet the Bank's standards and yet not safe enough to float on their own merits?"[9] The very fact that the Bank will, at least for some time to come, heavily depend on American investors, at present still highly wary of foreign ventures outside of the Americas, will force it to be extremely conservative in its own operations. But the greater this conservatism the less will the Bank be able to contribute to the extraordinary capital needs abroad. However adequate or inadequate the Bank's capacity will be in relation to these needs will be determined not only by the volume of its activities but also by the amount of private and, above all, government loans granted outside the Bank.

The Bank was not designed to exhaust all possibilities for international cooperation in the field of capital movements. Thus, the Bank can do little to offset the cyclical fluctuations to which the flow of private funds has been so conspicuously subjected in the past. On its own direct loans, the Bank may grant borrowers transfer moratoria of up to three years and extend the life of the loan. The Bank may also arrange to assume temporarily the servicing of its guaranteed issues. This "built-in" flexibility will prove useful should a wave of depression generate foreign-exchange shortages in debtor nations. However, the main difficulty which will then arise derives from the shrinkage in volume of new loans. Anticipating such deficiencies, the Bank might keep a large part of its capacity in reserve. Yet it seems improbable that the Bank will be able to resist the pressure for loans during times of high business activity and succeed in setting aside large resources for contra-cyclical lending. Moreover, should the depression be severe, the Bank would in any case depend on appeals to presumably unwilling private investors. For the Bank's own resources are far from large enough to let it play a decisive part as an international instrument for counteracting the world-wide impact of depression.[10] Such an instrument does as yet not exist.

[9] "Bretton Woods," *The Economist* (July 29, 1944), p. 139.

[10] Jacob Viner, "International Finance in the Postwar World," *The Journal of Political Economy,* LV (1947), p. 106.

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The record of the Bank will be affected, much more than the Fund's, by American dispositions and policies. In the Bank, United States influence does not solely result from the large number of votes it casts. The singular dependence of the world's borrowers and of the Bank on the American capital market gives a powerful formal veto right to the country's Director in the Bank [11] and, at the same time, an informal but far from negligible veto to Wall Street. It cannot be foreseen, at this time, whether Washington and Wall Street will pool their influence or which will be the stronger should they be guided by conflicting views. In any case American influence will express itself not only in the total assistance lent by the Bank, but also in the conditions of such assistance and in the selection of foreign borrowers.

In this connection it would be disingenuous not to hint at the possibility of political complications. True, political objectives are not supposed to affect the decisions of the Bank. It is also true that the American or any other government can always grant loans outside the Bank when political objectives are uppermost in their minds. But who, in these times, suspects governments of the super-human ability to ignore political considerations in its own counsels? Some political considerations cannot indeed be banned from the investigation of a borrower's prospective capacity to pay. Where and how can one draw the line? Wall Street and the private investor certainly remain free to follow their political predilections.

Record

The first year of the Bank's life was complicated by personnel difficulties on the highest echelon. Because of the importance of the United States as a source of credits, the Bank decided that its President should be an American. Unexpectedly, a willing candidate was not easily found. Eugene Meyer, a Washington newspaper publisher and businessman, finally agreed to serve but in December 1946 he resigned after only a few months in office. Apparently there was a conflict of opinion between Mr. Meyer and Emilio G. Collado, the American Executive Director of the Bank. Rumor has it that Mr. Collado pressed for a more active investment role than the Bank management was then prepared to play. In any event, for several months no successor could be found for Mr. Meyer until John J. McCloy agreed to serve as President. The reputation of the new President; the resignation of Mr. Collado and his replacement by Eugene Black, a vice-president of the Chase National

[11] When ratifying the Bretton Woods agreements, the Congress set up the National Advisory Council on International Monetary and Financial Problems. It is composed of the Secretary of Treasury, as chairman, the Secretaries of State and Commerce, and the Chairmen of the Boards of Governors of the Federal Reserve System and the Export-Import Bank. The American Directors in the Fund and Bank act under order from the Council.

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Bank; and the addition of several other American investment bankers to the Bank's staff; marked a change which was generally interpreted to signify close contacts with Wall Street. In view of the Bank's need of access to the New York investment market, this development was scarcely surprising.

During 1947, the Bank granted its first loans, totalling about $500 million by December 1. France received $250 million, bearing interest at 4¼ per cent and repayable over a period of 30 years beginning in November 1952. The Netherlands was granted a $195 million loan. Denmark received $40 million and Luxembourg $12 million. All credits were given in United States dollars except that the loan to Luxembourg was made available partly in Belgian currency. Additional applications totalled about $1,600 million. Chile wanted $40 million, Czechoslovakia $350 million, Iran $250 million, Mexico $209 million, Poland $600 million and Italy $250 million. There may have been further informal applications, for it is the Bank's policy to prefer informal exploratory discussions with prospective borrowers before any formal application is filed. This practice saves both the Bank and the unsuccessful applicant the unpleasantness of a rebuff.

In the "processing" of applications, the Bank has proven a painstaking investigator, probing not only the project for which funds are sought but also the borrower's entire economic position, including a survey of his agricultural, industrial and mineral resources, the state of his external trade and balance of payments, his past debt record, etc. In its Second Annual Report, the Bank also conceded explicitly that certain economic aspects of a prospective borrower's situation cannot be divorced from relevant political realities.

> "Though the Bank is precluded from making or denying loans to achieve political objectives, there is an obvious and necessary interrelation and inter-action between political events and conditions in any country. The soundness of any loan depends fundamentally on the financial and economic prospects of the borrower. In so far as those prospects may be affected by the conditions of political instability or uncertainty in the borrowing country, those political conditions must be taken into consideration." [12]

The Bank is thus adding political to economic analysis. Since there is no mechanical formula for appraising or forecasting any country's "political stability", the Bank's deliberations may be expected to reflect the political appraisals of those of its members which have or can sway the largest number of votes.

[12] International Bank for Reconstruction and Development. *Second Annual Report 1946-1947* (Washington, 1947), p. 17.

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While virtually all loans and applications were for dollar funds, the Bank could not dispose of more than $725 million in United States dollars and gold once all members had paid in 20 per cent of their subscriptions. The Bank was soon under pressure, therefore, to tap the American investment market. This was done on July 15, 1947, when the Bank floated two bond issues totalling $250 million. Both issues were substantially oversubscribed. Nevertheless, the Bank's management — in close contact with the financial community of New York — decided to proceed cautiously and place no further debentures during 1947.

IV The Bank and Fund in the Light of Current World Problems

East-West Tension

Contrary to the optimistic assumptions of the Bretton Woods planners in 1944, the Bank and the Fund find themselves enmeshed in the political and economic crises now bedevilling the world. The emerging East-West tension has not by-passed the two institutions. Poland, Czechoslovakia, and Yugoslavia are members but the USSR, though it participated in the Bretton Woods conference, never ratified the articles of agreement. To be sure, maintaining a complete state monopoly over foreign trade, Russia does not encounter the kind of problems which concern the Fund and she cannot therefore benefit from its facilities except insofar as Bank membership is contingent on Fund membership. The Soviet Union could obviously benefit from Bank loans.

To judge from scattered comments in the Russian press, Soviet hostility to the Bank and Fund is grounded in several considerations. First, the two charters concede no veto power to the USSR and, based on its quota, the USSR would be regulated to third place behind the United States and Great Britain. This is disagreeable to a prestige-hungry power. Secondly, Fund members are obliged to furnish exact information on gold production, gold and foreign-exchange holdings, and other data which the Soviets have customarily kept secret. Similarly, borrowing from the Bank involves submission to exacting investigations by Bank officials as well as arrangements for checking the spending of borrowed funds. Both Bretton Woods agencies, finally, are designed to promote foreign investments by private capitalists, relatively free and multilateral trading, and in general a world economic environment within which free-market and free-enterprise countries are apt to thrive. The USSR can scarcely be expected to cherish such a cause.

Despite certain statutory limitations, the Bank at least is deeply involved in and affected by world politics. In its fund-raising activities it depends on the political principles, moods, and prejudices of capitalist investors who are rarely indifferent to the political and economic regime of a prospective borrower. The United States Advisory Council exer-

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cises preponderant influence in the Bank's councils and this influence is likely to manifest the policies of the American administration. It would be foolish to deny that the lending operations of the Bank and, to a lesser extent of the Fund, may have political repercussions, and especially so during the unsettled postwar period. How can the "soundness" of a loan to Poland or Yugoslavia be appraised without looking into the internal and external politics of these countries? In fact, Mr. McCloy has stated that Poland's refusal to attend the Paris Conference on a European Recovery Program seriously raised the question of that nation's political independence from Russia and its ability to guarantee repayment of a loan.[13]

Polish representatives have complained of the "credit blockade" directed against their country. They pointedly warned that the political treatment of world financing problems would force the victimized nations to rely on bilateral arrangements with Russia. At Lake Success, the Soviet Union has accused the Bretton Woods institutions of being "merely branches of Wall Street" and charged that the Bank was "subordinated to political purposes which make it the instrument of one great power."[14] The Soviet bloc at first opposed the terms on which the Bank and the Fund agreed to become formally attached, as specialized agencies, to the United Nations. These terms granted to the institutions complete operational and budgetary autonomy and explicitly stated that the United Nations was even to refrain from recommending loans to the Bank.[15] However, the Assembly adopted the proposed arrangement, with the USSR and other opponents abstaining from the balloting.

Given the complex interdependence of economic and political conditions, the Fund and, especially, the Bank can scarcely be criticized for becoming embroiled in political conflicts. Nor, as constituted, can they be expected to act in disregard of political motivations. It might be wise if influential members, particularly the United States, resist the temptation of letting political concerns excessively guide their voting. Yet such self-restraint is not encouraged as long as political antagonisms maintain their present acerbity.

The Dollar Crisis

Another criticism of the Bretton Woods agencies is inspired by the spectacle of two international funds with combined resources of over $15.5 billion playing a passive role in a dollar-starved world. Even aside from the fact that the available dollar resources of the agencies amount to less than $5 billion, this criticism is unjustified. It is based

[13] *New York Times*, November 5, 1947, p. 43.
[14] *Ibid.*, October 14, 1947, p. 4.
[15] For text of the agreement between the Bank and the United Nations, see this issue, p. 198.

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on a blend of misapprehension and despair. The Fund certainly was set up deliberately to operate in a world which had returned to relative normality. The Fund does not now insist on and thus has no cause for supporting free currency convertibility. Still, as Europe's dollar shortage increased in 1947, the sight of several billion idle dollars stimulated inspired rumors that the Fund may, and suggestions that the Fund should, take a broader view of its responsibilities. The Fund has indeed given an elastic interpretation to its instructions, for otherwise it could hardly have entered into its recent transactions with Britain. But it is improbable that, without a basic modification of its charter, it can go very far in this direction. Such action would weaken its capacity to perform the tasks for which it was created.

The Bank, of course, was expected in 1944 to supply the bulk of foreign reconstruction funds needed by the war-stricken economies. It was also expected then that a substantial portion of its resources would remain available for the foreign finance of development as distinct from rehabilitation projects. These assumptions were based on two misconceptions. First, the tremendous magnitude of reconstruction needs was not foreseen. Secondly, the reluctance of private investors to subscribe to foreign loans was underestimated and, hence, it was not foreseen that the Bank would be forced, at least initially, to build up a very conservative portfolio. Current calculations of the global dollar gap indicate the inadequacy of the Bank's dollar funds. Faced with overwhelming demands, the Bank has been emphasizing the principle of a strategic use of its modest resources. It is patently in no position to provide comprehensive stop-gap assistance. What it can do and, within its means, seems willing to do is to finance such specific projects as will eliminate bottlenecks obstructing generally rising production in the countries concerned.

Under the circumstances, this is an admirable principle. Yet, as some critics ask, is it applied boldly enough? To ask this question is to ask why the Bank has not been more active in raising capital. In this, however, the Bank's program is limited by the cautious sentiments of the investment market. Has the Bank management misinterpreted this sentiment or, as seems more likely, is this sentiment simply a consequence of the discouraging state of world affairs?

The Bank and ERP

The Paris Committee of European Cooperation has suggested that the 16 European countries' requirements of imported equipment might be financed by the Bank. The amount mentioned is $920 million during 1948 and $3,130 million during the four-year period.[16] This proposal

[16] Committee of European Cooperation, *Volume I: General Report,* (Washington, 1947), p. 54.

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presents the Bank both with an opportunity and with difficulties. The Marshall Plan aimed at political objectives and the European Recovery Program has become a world political issue of the first order. Next, the Bank has 30 members in addition to the 16 members involved in the ERP. Already Latin American and Asiatic spokesmen resent the favoritism hitherto enjoyed by western Europe. The Bank can scarcely disregard this pressure and continue straining its resources in exclusive assistance of western Europe. It will have to divide its help between rehabilitation and development programs and, geographically, distribute it more evenly.

On the other hand, an adequate ERP would provide a good basis for a more enterprising investment activity of the Bank in support of European recovery. The number of "sound" projects may increase as recovery proceeds, inflationary forces are contained, and external accounts stabilized. Thus, large-scale American help outside the Bank may, on the one hand, relieve the pressure on the Bank to make loans it considers unsound under present circumstances. On the other hand, the market for Bank offerings may improve once European recovery progresses. This condition, however, may induce the Bank to await ERP developments. It seems unlikely that the Bank will be able to contribute much during 1948. Whether it can over the entire four-year period help as substantially as has been suggested at Paris cannot be predicted at this time.

The Bretton Woods Agencies in the Long Run

The Fund and the Bank are of limited usefulness in the present crisis. Whether they will ever function with full success depends on whether there ever will be the kind of world for which these institutions were designed. This is a point which many critics ignore. Under no circumstances, to be sure, are the Fund and Bank likely to prove a complete fiasco. Here or there, they will be able to relieve temporary maladjustments and channel funds into deserving projects. Above all, they must not be underrated as facilities for continuous consultation among the financial experts of many nations. But will they become vital underpinnings of a prosperous world of multilateral exchange? No definite answer to this question is, of course, possible now. By their own efforts these institutions cannot bring about such a world. And they can make their full contribution to it only if the world political crisis subsides, if the world recovers from the ravages of war, if the major industrial nations manage to ban severe and protracted depressions, and if the ITO will thrive on its positive principles rather than be emasculated through excessive use of its numerous escape clauses. Admittedly this is a formidable set of conditions.

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