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Chapter 4:

International Liquidity Provision: The IMF and the World Bank in the Treasury and Marshall Systems, 1942-1957

Jeffrey M. Chwieroth

Revisiting the early history of liquidity provision serves as a useful lens through which we can explore the early division of responsibilities between the International Monetary Fund (IMF, or Fund) and the International Bank for Reconstruction and Development (IRBD, or Bank). As I document below, both John Maynard Keynes and Harry Dexter White intended for the IBRD to be given explicit powers to help provide international liquidity.[1] In particular, Keynes and White envisioned the Bank as a provider of long-term stabilization loans and general purpose balance-of-payments financing.[2] However, inter-agency rivalries within the U.S. government, as well as disagreements between U.S. government officials and the other delegations at the Bretton Woods conference, produced a significantly watered down version of Keynes and White's shared vision. Instead of explicit powers to provide liquidity, the Bank was left with a rather ambiguous mandate.

The Bank was not alone in this respect, as similar contestation led to compromise language in the IMF's Articles that also left considerable ambiguity as to how access to Fund resources would be governed. Subsequent practice at both institutions was thus

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[1] International liquidity may be defined simply as the sum of all gold, international reserve stocks and all readily available international credits.

[2] By long-term stabilization loans I mean those loans that reconstitute or stabilize a country's gold and foreign exchange reserves rather than those loans that finance continuing payments deficits.

left open to interpretation. But the IMF and the Bank responded to these ambiguities differently. In the Fund's early years, U.S. officials used their influential position[3] to secure agreement on a series of interpretations that enabled the Fund to place restrictive policy conditions on access to IMF finance, leading to the development of the practice of loan conditionality. Restricting access to credit in order to extract economic adjustment or changes in policy from other countries was part of a more general U.S. strategy during this period to promote a specific set of monetary and economic practices abroad; thus Fund policy became one of the bulwarks of what this volume calls the Treasury System.

But the situation at the Bank was significantly different. In contrast to the IMF, the Bank's Executive Board failed to produce a definitive decision on its role in the provision of long-term stabilization and general purpose balance-of-payments loans, instead delegating this decision to staff. Although in principle U.S. officials exerted a degree of influence over the Bank similar to their role at the Fund, the unique

[3] U.S. officials have historically wielded enormous influence within the Fund, particularly during its early years. The most obvious means for exerting such influence is through the Board, where the IMF's weighted voting system gives the U.S. Director the largest share of votes and the capacity to veto decisions such as quota increases that require a supermajority. The U.S.'s international leadership role has also been critical; indeed, in the Fund's early years it was customary for potential borrowers to approach the U.S. Director about the possibility of a loan before dealing with the IMF management and staff. Finally, in addition to their status on the IMF's Board, U.S. officials also derive a more subtle form of influence through the so-called "Treasury effect," that is, the regular formal and informal contact that occurs between U.S. officials and the Fund's management and staff. This informal influence enables U.S. officials to circumvent the Board entirely, and address its demands directly to management and staff. For further discussion, see Miles Kahler, "The United States and the International Monetary Fund: Declining Influence or Declining Interest?," in *The United States and Multilateral Institutions: Patterns of Changing Instrumentality and Influence,* edited by Margaret Karns and Karen Mingst, (Boston: Unwin Hyman, 1990), pp. 91- 114; Ngaire Woods, "The United States and the International Financial Institutions," in *U.S. Hegemony and International Organizations,* edited by Neil MacFarlane and Michael Mastanduno, (Oxford: Oxford University Press, 2003), pp. 92-114.

circumstances surrounding the selection of the Bank's second president facilitated a significant degree of autonomy for the Bank's management and staff.[4] Policy contestation within the Bank—between program-oriented staff on the one hand, favoring stabilization and balance-of-payments loans, and project-oriented staff on the other, favoring project loans—therefore played a disproportionately large part in shaping the Bank's lending behavior.

The ebb and flow of this intra-organizational rivalry was such that the dominant interpretation of the Bank's mission changed over time. Initially, program-oriented staff gained the upper hand, leading the Bank to fulfill some of its anticipated liquidity provision roles. Indeed, in an often underappreciated period in the evolution of the Bretton Woods system, it was the IBRD that provided critical balance-of-payments loans that helped bridge the financing gap in western Europe prior to the provision of Marshall Plan aid. This strategic infusion of liquidity eased the pressures to adjust that were at the heart of the Treasury System and signaled the shift to more generous liquidity provision and policy accommodation that were fundamental to the Marshall System. Eventually, however, project-oriented staff became ascendant and the IBRD's role in liquidity provision faded away. By 1957 the Bank was no longer engaged in providing balance-of-payments loans; by that point, project-oriented staff had successfully constructed an organizational culture within the Bank that delegitimated the provision of stabilization

[4] For an overview of U.S. influence within the World Bank, see William Ascher, "The World Bank and U.S. Control," in *The United States and Multilateral Institutions: Patterns of Changing Instrumentality and Influence*, pp. 115-140; Woods, "The United States and the International Financial Institutions".

and balance-of-payments loans, leading to the Bank's withdrawal from these aspects of liquidity provision.[5]

In making these arguments, the chapter proceeds as follows. First, I discuss how the Bretton Woods agreements left considerable ambiguities regarding the IMF and Bank's respective responsibilities regarding liquidity provision. Section two draws special attention to the role—largely neglected in the existing literature—that Keynes and White envisioned for the Bank. The third section then shows how these ambiguities were dealt with in the early years of the Bretton Woods system. Interstate rivalry played very different roles in managing these ambiguities within the two Bretton Woods institutions, leading to a definitive interpretation of the Fund's mission and continued ambiguity for the Bank—an ambiguity that was resolved at the staff level, and must therefore be understood in terms of intra-organizational rivalries within the Bank. I show that, during the dollar shortage of the immediate postwar years, program-oriented staff within the Bank played a key part in providing liquidity at the same time that the Fund was developing its policy of strict loan conditionality. The fourth section then details how the evolution of this intra-organizational contestation ultimately led to a "project-oriented culture" within the Bank in the 1950s, a culture that facilitated a particular interpretation of the Bank's responsibilities that led the IBRD to withdraw from liquidity provision.

1. Liquidity provision in the Bretton Woods system: an incomplete tale

[5] Though the Bank did provide a small number of program loans in the 1960s and 1970s, it was not until the 1980s, with the introduction of structural adjustment loans, that it fully returned to its early liquidity-providing role.

There is an extensive literature exploring how the views of Keynes and White on liquidity were institutionalized in the IMF's Articles of Agreement; the principal debates only require brief discussion here.[6] During the period of planning for the postwar era, there was generally shared recognition that an adequate supply of liquidity in the form of prearranged credits was necessary for countries to maintain their exchange rate commitments without abandoning full employment policies, a belief consistent with the ambition to maintain high levels of national autonomy while expanding world trade. Intense debates took place regarding the size of the IMF's resources and the extent to which these resources should be made available "automatically."

In the end, agreement was reached to endow the IMF with $8.8 billion via quotas assigned to member states roughly based on the size of their national economies. Nevertheless, considerable ambiguity remained concerning the issue of access. As representative of a debtor nation, Keynes had sought to ensure international credit would be made available more or less "automatically;" as representative of the world's largest creditor nation, White wanted to place conditions on access. According to Gardner, "the automatic availability of the overdraft facilities was considered an essential feature by the British planners."[7] Writing to Jacob Viner in 1943, Keynes famously quipped that conditional lending would put the IMF in the position of being "too grandmotherly."[8]

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[6] There is extensive literature on the origins of the Bretton Woods system. The two most detailed accounts remain Richard Gardner, *Sterling-Dollar Diplomacy in Current Perspective* (New York: Columbia University Press, 1980) and Armand van Dormael, *Bretton Woods: Birth of a Monetary System* (London: MacMillan Press, 1978).

[7] Gardner, *Sterling-Dollar Diplomacy in Current Perspective*, p. 88.

[8] Quoted in Gardner, *Sterling-Dollar Diplomacy in Current Perspective*, p. 88.

The British view was generally shared by other Bretton Woods delegations, with the exception of the United States.

White's plans for the Stabilization Fund were never entirely clear on this point, placing no direct restraints on access to resources; yet charging the Fund to release its resources only under certain conditions. For instance, the Fund resources were to be limited to financing current account imbalances.[9] The absence of firm restrictions in the White plans led the American delegation to Bretton Woods to take a strong position that "discretion on the part of the Fund was essential if the Fund's resources were to be conserved for the purposes for which the Fund was established and if the Fund were to be influential in promoting what it considered to be appropriate financial policies."[10]

In the end, language was crafted in a manner that allowed both the British and the Americans to claim victory. The Articles provide that a state "shall be entitled" to borrow from the Fund provided only that the member "desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions" of the Fund Agreement.[11] This provision would seem to

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[9] Harry Dexter White, "Preliminary Draft Proposal for a United Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations" [April 1942], reprinted in *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Documents, edited by J. Keith Horsefield (Washington, DC:IMF), p. 41, 49-50, 89. See also U.S. Treasury Department, "Questions and Answers on the International Monetary Fund" [June 1944], reprinted in *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Documents, p. 166-168.

[10] Gardner, *Sterling-Dollar Diplomacy in Current Perspective,* p. 133.

[11] Article V, Section 3(i) reprinted in *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation, Vol. III, Documents*, p. 191. It should be noted that access to IMF resources was subject to quantitative limitations on the drawings that could be made in any given year, the limitation on drawing a currency that had been declared scarce, and several other exceptional circumstances.

suggest the British position had prevailed and that the Fund could not place additional conditions on access to its resources. However, Kenneth Dam suggests otherwise, indicating that U.S. officials believed that this language allowed for the possibility of conditional lending. If a means could be found to challenge the representations of members then, as Dam observes, "there was the possibility that [the Fund] might be able to exercise some discretion under cover of an assessment of need."[12] Other provisions of the Articles provided additional support for the U.S. position. For instance, the IMF retained the right to declare a state ineligible to use its resources if it determined that the member was using those resources "in a manner contrary to the purposes of the Fund."[13] Ultimately, as Gardner observes, "one could not be sure from the wording of the Articles themselves whether the British or American view on this subject would finally prevail."[14]

Analysis in the existing literature tends to stop here, confining itself to the discussions and negotiations over the Fund's creation. Missing from these accounts is a discussion of how the founders of the Bretton Woods system envisioned and fought for a role for the Bank to play in the provision of liquidity. Though Keynes and White always envisioned the IMF as taking the lead role in the provision of short-term stabilization loans, and the IRBD taking primary responsibility for long-term development financing,[15]

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[12] Kenneth W. Dam. 1982. *The Rules of the Game: Reform and Evolution in the International Monetary System* (Chicago: University of Chicago Press), p. 117.

[13] Article V, Section 5 reprinted in *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation, Vol. III, Documents*, p. 192.

[14] Gardner, *Sterling-Dollar Diplomacy in Current Perspective*., p. 114.

[15] For White's views on the logic of this separation, see Harry Dexter White, "Preliminary Draft Proposal for a United Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations" [April 1942], reprinted in Robert Oliver, *International Economic Cooperation and the World Bank* (London: MacMillan, 1975), p. 281-282.

one critical aspect missing from the standard account is that both men also envisioned the Bank playing a supporting role in the provision of liquidity (or balance-of-payments financing). As Roy Harrod observes, “One has to remember that White originally conceived his Fund in conjunction with an extremely ambitious International Bank.”[16] A fuller understanding of liquidity in the Bretton Woods system thus necessitates an exploration of how Keynes and White envisioned the IMF and Bank’s roles in the Bretton Woods system jointly and not in isolation.

2. The Bank’s envisioned role in liquidity provision

To understand the Bank’s role, one must first recognize that the IBRD—in contrast to the IMF—was essentially an American proposal and thus was shaped largely by the views of the American delegation to Bretton Woods.[17] For White, as further documented below, the Bank’s role seems to have been a matter of first principles, as he mentions it in his earliest proposal for what eventually became the Fund and the Bank. On the other hand, Keynes’s view of the Bank’s role was likely more tactical in nature. For him, a key goal in the wartime planning negotiations was to secure a generous and automatic supply of liquidity so that governments could pursue full employment policies relatively free of balance-of-payments constraints. In pursuing this goal Keynes had, according to Harrod, “somewhat neglected” the issue of the Bank initially and instead concentrated his energies on fighting for a version of his International Clearing Union

[16] Harrod, *The Life of John Maynard Keynes* (London: MacMillan), p. 552,

[17] Edward S. Mason and Robert E. Asher, *The World Bank Since Bretton Woods* (Washington, DC: Brookings Institution, 1973), p. 13; Oliver, *Early Plans for a World Bank*, p. 9-10; Harrod, *The Life of John Maynard Keynes*, p. 533.

(ICU) proposal.[18] However, in 1944, after agreement had been reached between the Americans and the British on the Joint Statement regarding the Fund, it seems likely that Keynes recognized the Americans were not going to accede fully to his preferences on liquidity. He then turned his attention to ensuring the Bank could provide as many resources in this area as possible.[19]

Because of its origins, however, all of the preliminary work on the IBRD had been done within the U.S. government. Indeed, the Bank's historians describe the input of other countries prior to the Atlantic City meeting in June 1944 as "perfunctory."[20] It was not until shortly prior to the Atlantic City meeting that the British offered the first substantial comments by a foreign government on the proposed international bank.[21] Their draft—which was subsequently referred to as the "Boat Draft," since it was crafted as the British delegation traveled from London on the *Queen Mary*—was shown to the Americans just prior to the Atlantic City meeting. After comparing the Boat Draft with the American draft, White concluded: "They seem to be in accord with the general approach that we have proposed, though there are some substantial differences which will have to be ironed out at Bretton Woods. It seems we are not as far behind on the Bank proposal as we had thought."[22]

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[18] Harrod, *The Life of John Maynard Keynes*, p. 575-576.

[19] Harold James, *International Monetary Cooperation Since Bretton Woods* (Washington, D.C.: IMF, 1996), p. 47, 53 and Van Dormael, *Bretton Woods*, p. 198.

[20] Mason and Asher, *The World Bank Since Bretton Woods*, p. 12.

[21] To be sure, the British offered comments on the American proposals, but no attempt was made prior to the Boat Draft to offer a formal draft proposal.

[22] Quoted in Mason and Asher, *The World Bank Since Bretton Woods*, p. 13. See also p. 20.

Before considering how the Bank's role took shape at Atlantic City and Bretton Woods, it is important to examine the origins of the American proposal. As was the case for the American proposal for what later became the IMF, White was the central figure. Although others within the American government concerned with post-war planning had turned their attention to the possibility of an international bank and would be involved in elaborating the American position, it was essentially White's April 1942 "Proposal for a United Nations Stabilization Plan and a Bank for Reconstruction and Development of the United and Associated Nations" that shaped subsequent discussions.

a. Conflicting visions for the Bank: project financing versus stabilization loans

In establishing the IBRD, the principal intention of the Americans was to create an institution that would facilitate the flow of long-term international capital movements, which they feared would be in short supply in the immediate post-war era. The American view as to how the Bank's long-term investment capital should be employed was in turn shaped by the experience of the interwar years, including discussions about a proposed Inter-American Bank (IAB) (as discussed further below).[23] The resulting approach, however, contained diverse and to some extent conflicting objectives.

On the one hand, White and others in the American government wished to avoid the ill-considered balance-of-payments loans of the 1920s, when the use of the proceeds was generally left unspecified. During this period U.S. investors had purchased bonds for general purpose financing—what the Bank would later call program loans—in many

[23] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation, Vol. I, Chronicle* (Washington, DC: IMF, 1969), p. 10-11; Mason and Asher, *The World Bank Since Bretton Woods*, p. 25; Oliver, *International Economic Cooperation and the World Bank*, p. 78.

Latin American and European municipalities. These investments rarely contributed to the productive capacity of borrowers and were often made without reference to creditworthiness. In the view of the U.S. delegation, this type of investor behavior was partially to blame for the large-scale defaults of the 1930s; they therefore wanted to ensure that future long-term lending by the proposed Bank would avoid these errors. Loans were to be made for specific and productive purposes. The 1942 White Plan—which he had formulated largely on his own—thus contained language directing that a "loan is made only after a careful study and written report by a competent committee on the merits of the project and the loan."[24]

On the other hand, White also wanted the proposed Bank to play some role in liquidity provision—though the role he envisioned for the Bank on this front would become more limited as the discussions and negotiations unfolded. White's thinking was shaped in part by earlier discussions on the proposed IAB, which although it never came into existence, had important similarities with the institution envisioned in his proposals.[25] The IAB plan was a project of the State Department, but the Treasury Department (and White himself) were also involved in the discussions. The intended mandate of the IAB was to "assist in stabilizing the currencies of the American Republics; encourage general direct exchanges of the currencies of the American Republics; encourage the maintenance of adequate monetary reserves; promote the use

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[24] White, "Preliminary Draft Proposal," pp. 291, 299-300.

[25] For a treatment of the IAB proposal, and its relation to the genesis of the IBRD, see Raymond F. Mikesell, *United States Economic Policy and International Relations* (New York: McGraw-Hill 1952), pp. 193-194; and Eric Helleiner, "Reinterpreting Bretton Woods: International Development and the Neglected Origins of Embedded Liberalism," *Development and Change* 37, no. 5 (2006), pp. 943-967.

and distribution of gold and silver; and facilitate monetary equilibrium."[26] The IAB would also "function as a clearing house for…the transfer of international payments, make loans, buy and sell the securities of any of the member governments or their political subdivisions or private entities, guarantee credits in gold and foreign currencies, discount bills and other credit instruments, accept deposits, and perform normal banking functions."[27] Thus, in many respects, the IAB plan closely resembled the functions of a stabilization fund, a world central bank, and a commercial bank.

Later, many of these functions were incorporated into the IMF; but the IAB's mandate to stabilize monetary systems and currencies was carried over into White's 1942 plan for the Bank. In White's initial draft, he noted that, at the end of the war, "monetary and banking reserves will be depleted" and "there will doubtless be opportunities [for the Bank] to make loans for the purpose of providing metallic reserves or otherwise strengthening the monetary systems of the borrowing country." White envisioned the Bank as providing metallic reserves (gold) to borrowers as a means "to promote monetary stability;" and that these loans "should bear lower rates of interest and longer terms of repayment than loans made for other purposes." White offered three reasons for his views:

> In the first place, such loans do not yield profits to the borrowing country of a character which are easily measurable. The charge on the budget of servicing of the loan is a burden that can be justified only on general grounds. The encouragement to make loans for such purposes would be greater were the interest very low. Secondly, it would help defeat the purpose of the loan if high interest rates were charged, inasmuch as the

[26] Draft Charter for Inter-American Bank quoted in Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation, Vol. I, Chronicle*, p. 11.

[27] Draft Charter for Inter-American Bank, quoted in Mason and Asher, *The World Bank Since Bretton Woods*, p. 16.

> burden caused by the loan would in that case tend to vitiate rather than to strengthen the benefits the loan might otherwise have. Finally, it might be said that in many cases the risk involved in lending metallic reserves for a monetary system under proper circumstances are less than other types of loans.[28]

White's initial vision of the Bank also provided it with many of the functions of a stabilization fund and world central bank that had previously been intended for the IAB. In addition, he envisioned the Bank as playing a role in the supply of short-term capital for financing international trade.[29] Perhaps the most unconventional element in White's initial plan was granting the proposed Bank authority to issue non-interest bearing notes backed by subscriptions of gold and local currency from member governments.[30] As Robert Oliver observes, "White obviously intended that these notes should serve, like gold, as…a medium of exchange."[31]

That said, White's proposed Bank would not have acted in similar fashion to Keynes's proposed supranational bank or Robert Triffin's proposal for a world central bank. For example, White's International Bank notes would not have been regulated with an eye to world price stability, and would not have served as monetary reserves.[32]

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[28] White, "Preliminary Draft Proposal," pp. 298 and 304; see also pp. 291 and 297 (on gold reserves) and p. 292 (on below-market interest rates).

[29] See White, "Preliminary Draft Proposal," p. 291, 297; Oliver, *Early Plans for a World Bank*, p. 27; Oliver, *International Economic Cooperation and the World Bank*, p. 113.

[30] See White, "Preliminary Draft Proposal," pp. 292, 304-311.

[31] Oliver, *International Economic Cooperation and the World Bank*, p. 114; see also p. 123.

[32] Oliver, in *Early Plans for a World Bank*, p. 30, notes: "White did not have much sympathy with the gold standard as a regulator of the supply of money; either at the national or the international level. But he had great respect for gold as an international medium of exchange. This may explain why he did not propose that national currencies should be based on his International Bank notes, though he was interested in supplementing gold as an international medium of exchange provided that the creation of these notes was related to a corresponding increase in productivity."

Nevertheless, Oliver estimates that had the proposed Bank notes been incorporated into the Bank's Articles, and had governments been willing to accept and hold them, the Bank would have been endowed with a liquidity-creating capacity of at least $60 billion.[33]

b. Watering down the White Plan

In May 1942 President Roosevelt authorized the pursuit of discussions of White's proposal in an interdepartmental group known as "the Cabinet Committee." The Cabinet Committee was in turn served by the American Technical Committee (ATC), a group White chaired and consisting of experts from a variety of agencies, including the Departments of Treasury, State, and Commerce, the Securities and Exchange Commission, the Export-Import Bank, the Federal Reserve, and the Foreign Economic Administration. The ATC was made responsible for drafting future versions of the American position.

White's initial plan for the Fund and the Bank was shared with some British officials—including Keynes—in July 1942; Keynes's plan for the ICU was in turn shared with the Americans in August. The Americans were initially puzzled by Keynes's idea to locate the authority to issue an international currency within the ICU.[34] In the U.S. Treasury and State Departments' first set of questions addressed to the British asking for clarification of Keynes's proposal, they asked: "If any international agency is to have the authority of issuing an international currency, would it not be more appropriate to reserve

[33] Oliver, *Early Plans for a World Bank*, p. 35. See also p. 30-36 and Oliver, *International Economic Cooperation and the World Bank*, p. 115-117, 138.

[34] See Dell, "A Note on Stabilization and the World Bank," *World Development* 12, no. 2 (1984), p. 166.

such authority for the International Bank?"[35] However, after an exchange of notes between Keynes and the ATC, it was agreed that the Fund should be considered before the Bank.

Meanwhile, the ATC continued work on the Bank, and White's initial vision for its liquidity provision role remained in place. In fact, the only major change completed was that the Bank would no longer be permitted to redeem its own notes—now referred to as "Unitas"—in gold. Instead, only the Fund could redeem them, and only in foreign currency.[36]

But the December 1942 draft was the last version White devised in which the Bank was given the power to issue notes.[37] White prepared another draft in August 1943 and circulated it to some British officials and to the ATC. Although the Unitas remained in this draft, they were to be used only as an internal unit of account: the Bank could no

[35] Quoted in Dell, "Stabilization and the World Bank," p. 166.

[36] White wanted the Unitas to finance international transactions without subjecting the Fund to a loss of gold reserves.

[37] In accounting for this change, Oliver, in *International Economic Cooperation and the World Bank*, p. 139, suggests that White came to realize that if governments were unlikely to accept and hold Bank notes when they were redeemable in gold and on demand, it was even more unlikely they would do so if the notes could only be exchanged at the discretion of the Fund. Gardner, on the other hand, emphasizes how the 1942 Congressional elections had shifted the domestic balance of power on economic issues to a conservative coalition of Republicans and Southern Democrats. "Unrepentant New Dealers," according to Gardner, in *Sterling-Dollar Diplomacy in Current Perspective,* p. 77, "were being ousted by more conservative leaders recruited from the ranks of finance and industry….[As a result,] the more ambitious aspects of the Bank plan were gradually eliminated." Some ATC members also regarded the proposal as impossible to sell to Congress, see Oliver, *International Economic Cooperation and the World Bank* p. 158.

longer issue Unitas notes to finance its loans. The August 1943 draft also contained operational procedures for the Bank to provide short-term financing for trade.[38]

In subsequent ATC discussions, White continued to push for language, such as that included in an April 1943 draft, that would enable the Bank's resources to be used for "providing metallic reserves or otherwise strengthening the monetary systems of the borrowing country," although other ATC members generally opposed granting this authority to the Bank.[39] Subsequent drafts were prepared in September 1943 for discussions with the British and a version was eventually made public in November; it was the first such draft to fail to indicate explicitly that the Bank had a role to play in strengthening the monetary systems of member states and providing short-term financing.[40] The key arguments raised within the ATC against these roles focused on White's proposal to lend gold at negligible rates of interest. Some ATC members were convinced that such measures would be resisted by the U.S. Congress and the banking community. Other ATC members saw it as the Fund's responsibility to provide these sorts of loans, not the Bank's.[41] As a result, the most significant liquidity-providing power that the Bank could have been granted—to issue notes in support of its mission—was completely removed.

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[38] Oliver, *International Economic Cooperation and the World Bank*, p. 141.

[39] As stated in paragraph 5 of the April 1943 version of the White Plan and cited in Raymond Mikesell, *The Bretton Woods Debates: A Memoir*, Essays in International Finance No. 192 (Princeton, NJ: International Finance Section, Department of Economics, Princeton University), p. 31. See also Oliver, *International Economic Cooperation*, p. 146. On ATC opposition, see Mikesell, *The Bretton Woods Debates: A Memoir*, p. 31.

[40] Oliver, *International Economic Cooperation and the World Bank*, p. 156, 157.

[41] Oliver, *International Economic Cooperation and the World Bank*, p. 157, 164.

Opposition within the ATC had also resulted in the removal of references to the Bank's role in stabilizing monetary systems. But contrary to the conclusions drawn in the conventional narrative of the Bank's origins, this did not mean that Keynes and White had come to regard the Bank as playing no role in liquidity provision at all. The November 1943 draft still contained language that left open the possibility that the Bank could be involved in the provision of stabilization and general balance-of-payments loans—for example, provisions indicating that the Bank could provide financing for "programs" as well as "projects."[42]

c. Crafting the Bank's charter

Discussions with the representatives of a number of countries on the proposed "World Bank" continued through June 1944, when the British presented the Boat Draft. The Boat Draft contained many specific proposals, most of which did not conflict with the American draft in any important respect. But the British did push for more specific statements to be written into the Bank's Articles that would empower it to make stabilization loans to strengthen domestic monetary systems and to make general balance-of-payments loans, a proposal that also received strong support from the Dutch and Czech delegations.[43] Thus while the Boat Draft emphasized loans for "specific projects

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[42] Mason and Asher, *The World Bank Since Bretton Woods*, p. 19, 24.

[43] Oliver, *International Economic Cooperation and the World Bank*, p. 175-175; Mason and Asher, *The World Bank Since Bretton Woods*, p. 24; Mikesell, *The Bretton Woods Debates: A Memoir*, p. 33; Henry J. Bitterman, "Negotiation of the Articles of Agreement of the International Bank for Reconstruction and Development," *International Lawyer*, 5, no. 1 (1971), p. 63, 67, 70, 75, 76. On the other hand, less developed countries, particularly those in Latin America, were generally not supportive of this proposal. These countries, whose reserves had been greatly increased during the war, were more

of reconstruction and development," it went on to state that, in special circumstances and in agreement with the Fund, the Bank could "make or guarantee a loan which provides the borrowing country with gold or foreign exchange with the purpose of establishing its exchanges and allowing a breathing space for the recovery of its economy and balancing of its international payments."[44] But the ATC had already dropped broadly similar language from White's initial plans and did not wish to revisit the issue.[45] As a result, this issue was generally avoided at the Atlantic City meeting. In June 1944, White prepared a memorandum to Secretary Morgenthau summarizing the suggestions he received from various delegations at Atlantic City and the initial reaction of the American technical experts. The first item on the memorandum appears as follows:

A number of countries wish to have the Bank make loans in gold for currency reserves. The U.S. technical advisers are opposed.[46]

The final text of the Articles agreed to at Bretton Woods was a revision of the American draft written in April 1944. In spite of the position White had taken in his initial drafts, the American delegation—thinking that Congress would prefer a more "conservative" Bank—now generally opposed granting the Bank explicit authority to make stabilization and general balance-of-payments loans.[47] With respect to

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interested in the Bank making loans for development rather than monetary stabilization. See p. 71.

[44] As cited in Oliver, International Economic Cooperation and the World Bank, p. 175 and Mason and Asher, *The World Bank Since Bretton Woods*, p. 24-25.

[45] See Mason and Asher, *The World Bank Since Bretton Woods*, p. 20; Mikesell, The Bretton Woods Debates: A Memoir, p. 34.

[46] Cited in Mason and Asher, *The World Bank Since Bretton Woods*., p. 20. See also Mikesell, *The Bretton Woods Debates: A Memoir*, p. 34.

[47] Mikesell, *The Bretton Woods Debates: A Memoir*, p. 33. A detailed exposition of the view of the American technical experts on these issues was made available to the Bretton

strengthening monetary and exchange systems, the American technical advisers concluded that "the establishment of the Fund and the provision of foreign exchange resources in this manner is the most economical and most efficient method of securing public confidence in the stability of exchange rates….[And], for this reason…it would be desirable to avoid loans of this character through the Bank for Reconstruction and Development."[48] As for general payments support, the American advisers indicated greater flexibility. "It would be desirable in some instances to provide loans of this character," although such loans "should be carefully safeguarded from abuse and should be extremely limited in amount."[49]

Keynes and others, however, continued to fight to give the Bank more expansive authority to provide such loans. Opening the first session of the Bretton Woods conference commission on the Bank, Keynes, as the commission's chairman, stated that an important duty of the Bank was "to develop the resources and productive capacity of the world…so as to order its operations as to promote and maintain equilibrium in the international balances of payments of all member countries."[50] Despite American misgivings, this view—which garnered some support from other nations at Bretton Woods—was to some extent introduced into the final Bank's Articles. For example, one important modification to the American draft was additional language, presented here in italics, indicating that the purposes of the Bank included promotion of "the long-range

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Woods delegations in *Questions at Issue on the Bank,* Issue No. 1 and No. 2 and partially reproduced in Oliver, *International Economic Cooperation and the World Bank*, p. 193-194.

[48] Quoted in Oliver, *International Economic Cooperation and the World Bank,* p. 194.

[49] *Ibid*.

[50] Quoted in Mason and Asher, *The World Bank Since Bretton Woods*, p. 62.

balanced growth of international trade *and the maintenance of equilibrium in the balances of payments.*"[51] Another important modification, again indicated in italics, specified that "loans made or guaranteed by the Bank shall, *except in special circumstances*, be for the purpose of specific projects of reconstruction and development."[52]

This passage, which came to be known as the "specific project provision," was notably ambiguous. The language bowed to American concerns that Bank loans be tied to specific and productive purposes while at the same time reflecting the original concerns of White, and of other delegations to the Bretton Woods conference, that the Bank should be able to provide stabilization and general balance-of-payments loans. And after the conference, both White and Keynes maintained that the "special circumstances" language was indeed intended to confer on the Bank the authority for such lending.[53]

d. Ratification and the Bank's role in liquidity provision

Upon finalization, the Bretton Woods agreement was sent to various national parliaments for ratification, where various aspects of the agreement were vigorously debated. For present purposes, the key issue is the extent to which the Bank was viewed as having a role in liquidity provision—an issue addressed most extensively in the debates in the U.S. Congress, where the principal opposition to the agreement came from the American Banking Association (ABA). The general idea for the Bank, the ABA felt,

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[51] Oliver, *International Economic Cooperation and the World Bank*, p. 184. See Article I, Section III.

[52] Article III, Section 4, Clause VII.

[53] Ibrahim Shihata, *The World Bank Legal Papers* (The Hague: Martinus Nijhoff Publishers, 2000), p. 778 fn13.

was sound, because it “embodies satisfactory principles and procedures, and if we assume good management, the institution should be able to operate soundly and effectively.”[54] The ABA and other banking associations were less enthusiastic about the Fund, and therefore wanted the Bank to assume the task of stabilizing exchange rates and providing investment. The ABA therefore presented an alternative plan to combine the Fund and the Bank.

The battle to secure ratification lasted for nearly five months, ending in July 1945. A key moment in the debate occurred in late March, when the Committee on Economic Development (CED) proposed a compromise that enabled the banking community and the administration to resolve their differences. Earlier, the Research Committee of the CED—headed by the Presidents of the Federal Reserve Banks of Boston and St. Louis, and including among its members Paul Hoffman, who subsequently became Administrator of the Marshall Plan—had examined the Bretton Woods plans and issued a report concluding that the plans were not sufficiently broad, especially with respect to provision of long-term stabilization and general balance-of-payments loans.[55] Despite verbal assurances from U.S. Treasury spokesmen, the Committee feared that the special circumstances language in the specific project provision was not expansive enough to accommodate such loans. Their report stated:

> There will probably be a need for long-term loans of a type for which there is no provision present under either the Bank or the Monetary Fund. The Bank’s loans, as at present provided, are to be for specific projects of reconstruction and development; but there will probably be a number of countries that will need some more general form of loan assistance than these specific projects imply—loans designed to provide for imports of a

[54] *New York Times*, 5 February 1945 p. 21

[55] Committee for Economic Development, *The Bretton Woods Proposals* (Washington DC: CED, 1944).

> variety of goods and services in a general restoration of a country's powers of production and trade….The managers of the Fund require and deserve the protection of clarity of their operation that would come from clear authority to the Bank to make loans for stabilization purposes when they are justified.

This conclusion was widely shared in the American banking community; indeed, the ABA's President, Rudolph Burgess, had testified during the Congressional hearings on the Bretton Woods plans that "some stabilization programs will call for long-term loans."[56] The CED's compromise proposal was therefore to endorse both the Fund and the Bank, but to recommend that the Bank be allowed to make long-term stabilization and general balance-of-payments loans, whereas the loans of the Fund should be restricted to countering short-term exchange rate fluctuations. The plain intention of this proposal—which the ABA accepted in May—was to reduce somewhat the importance of the Fund in providing liquidity; and the banking community's views on this matter dovetailed with the interests of some members of Congress who sought to prevent IMF resources from being used to provide loans for relief or reconstruction.[57] Accordingly, Section 12 of the Bretton Woods Agreements Act, as adopted by Congress, directed the U.S. Governor and Director of the Bank:

> to obtain promptly an official interpretation by the Bank as to its authority to make or guarantee loans for programs of reconstruction and the reconstruction of monetary systems, including long-term stabilization. If the Bank does not interpret its powers to include the making or guaranteeing of such loans, the governor of the Bank representing the United States is hereby directed to propose promptly and support an amendment to the Articles of Agreement for the purpose of explicitly authorizing the Bank, after consultation with the Fund, to make or guarantee such loans.[58]

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[56] As cited in Dell, "A Note on Stabilization and the World Bank," p. 166.

[57] Gardner, *Sterling-Dollar Diplomacy in Current Perspective,* p. 134, 263.

[58] Bretton Woods Agreements Act. Public Law 171, 79 Congress 1 session (21 July 1945), Section 12.

Thus, ironically, it was the U.S. Congress—which members of the ATC had believed would reject such powers for the Bank, and therefore removed them from White's proposal—that ultimately directed the administration to ensure the Bank retained a role in liquidity provision. In Keynes's view, the proposal of the U.S. Congress appeared obviously correct: "The interpretation that the Bank is free to make stabilization loans is entirely unexceptionable from our point of view. It is just how we always understood it."[59] Keynes later elaborated his view, claiming that "there can be no doubt that the Bank both has and was intended to have, the necessary authority [to make or guarantee loans for the reconstruction of monetary systems, including long-term stabilization loans.] We could without hesitation support the Americans, both in the matter of interpretation and also in voting for a change in the constitution, should it come to that."[60]

In accordance with this provision of the Bretton Woods Agreements Act, the U.S. governor raised the issue at the March 1946 inaugural meeting of the IMF and the IBRD in Savannah, Georgia; and the governors in turn agreed to refer the issue to the Bank's Board for interpretation. The Bank's Committee on Interpretation then issued a report, subsequently supported by the Board, that concluded:

> Under Article III, Section 4 (vii) of the Articles of Agreement [the specific project provision], the Bank, while primarily expected to make or guarantee loans for specific projects of reconstruction and development, does have the authority to make or guarantee loans for programs of economic reconstruction and the reconstruction of monetary systems, including long-

[59] Donald Moggridge, ed, *The Collected Writings of John Maynard Keynes*, Volume XXVI (London: Cambridge University Press), p. 194-195.

[60] Moggridge, *The Collected Writings of John Maynard Keynes*, Volume XXVI , p. 198.

> term stabilization loans, even if such loans are not for specific projects of reconstruction and development.[61]

Ultimately, however, the report offered no firm directives or guidance on how to use this authority and instead left "the Bank [management and staff] to decide whether special circumstances exist which justify it in making or guaranteeing such loans."[62] The Bank's Board thus confirmed that the IBRD indeed had a role in liquidity provision, but left it open to future interpretation the conditions under which such lending might be permissible.

3. Early frameworks for liquidity provision: IMF conditionality & IBRD lending

The discussion thus far has focused on the debate regarding the role of the Bank as a partner of the Fund in liquidity provision; I now turn to the ensuing practices of both the Bank and the Fund. As we shall see, differences in the approaches of these two institutions help account for some of the distinctive features of the Treasury system, as well as for the mechanics of the eventual transition to the Marshall system.

a. The push for early sterling convertibility and the emergence of the Treasury system

Prior to the achievement of current account convertibility in western Europe in 1958, gold and the U.S. dollar were the principal vehicles through which payments could

[61] Report of the Executive Directors to the Board of Governors on the Interpretation of the Articles of Agreement reprinted in World Bank, *First Annual Report,* (Washington, DC: World Bank, 1946), p. 26.

[62] World Bank, *First Annual Report*, p. 26.

be settled; the availability of liquidity was thus dependent on the Fund's resources plus the international supply of dollars and gold. White and others within the American government initially viewed the IMF's pool of resources—$7.5 million after the first payment of quotas—as sufficient to deal with most of the world's payments problems.[63] This belief, however, was quickly shown to be entirely unrealistic.[64] At the end of the war, western Europe and Japan's gold and dollar reserves were depleted and both faced severe balance-of-payments deficits.[65] Thus, for more than a decade following the war, the international monetary system suffered from a dollar shortage.

During the discussions and negotiations on the Bretton Woods agreement, the U.S. position on liquidity had been torn between two conflicting goals. On the one hand, those U.S. policymakers with Keynesian leanings recognized that the monetary system required a generous supply of liquidity to enable the Europeans to move toward greater economic openness while at the same time permitting sufficient autonomy for the pursuit of policies directed toward full employment.[66] On the other hand, U.S. policymakers

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[63] The initial IMF quotas were reduced from $8.8 billion to $7.5 billion because some countries—notably the Soviet Union—decided not to join. See James Boughton, "Why White, not Keynes? Inventing the Post-war International Monetary System," IMF Working Paper WP/02/52 (Washington, DC: IMF), p. 17, and the discussion by Xenias (in this volume).

[64] White—who served as American IMF Executive Director from May 1946 – March 1947—apparently came to the realization in early 1947 that he had underestimated the demand for liquidity in the early postwar years; he therefore proposed an amendment to the IMF's Articles that would create a new reserve asset to supplement the IMF's resources. However, the Board never formally considered the proposal. See Boughton, "Why White, not Keynes?," p. 18.

[65] Michael Bordo, "The Bretton Woods International Monetary System: A Historical Overview," in *A Retrospective on the Bretton Woods System*, edited by Michael D. Bordo and Barry Eichengreen (Chicago: University of Chicago Press, 1993), p. 38-39.

[66] Gardner, *Sterling-Dollar Diplomacy in Current Perspective*, p. 76 and van Dormael, *Bretton Woods*, p. 52.

with more orthodox views sought to create a more market-oriented supply of liquidity.[67] These orthodox officials—who gained prominent positions in the Treasury Department in new Truman administration—were also anxious to avoid inflationary pressures and not to underwrite the payments deficits of European states. Whereas the Keynesian view led to an emphasis on increasing liquidity available to the system, the orthodox view stressed the use of adjustment measures (devaluation and deflation) by deficit countries. This tension in American policy would be resolved in different fashions at different times; but the initial result was the adoption of a set of orthodox measures that constituted the core of the Treasury system.

One indication of the early ascendancy of the orthodox position was the push by U.S. officials for the British to adopt sterling-dollar convertibility.[68] As a second convertible currency, it was believed that sterling would ease demand for dollars and provide a more market-oriented source of liquidity than Keynes and his supporters had envisioned. But massive capital flight, coupled with the unwillingness of European governments to deflate in order to restore payments equilibrium, doomed early efforts to make sterling convertible, and a massive payments crisis soon gripped western Europe.[69] The depth of that crisis, in conjunction with changes in the international political

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[67] Fred Block, *The Origins of International Economic Disorder: A Study of United States International Monetary Policy from World War II to the Present* (Berkeley: University of California Press, 1977), p. 55 and Gardner, *Sterling-Dollar Diplomacy in Current Perspective,* p. 319.

[68] See Gardner, *Sterling-Dollar Diplomacy in Current Perspective,* and Xenias (this volume, chapter 3).

[69] See Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, NY: Cornell University Press, 1994) , p. 52-58.

environment,[70] eventually prompted a dramatic shift in U.S. liquidity policy. But it took some time for this change to take place, and in the interim other features of the Treasury system became evident.

b. The origins of IMF conditionality

For example, financial orthodoxy was reflected in U.S. efforts to limit the purposes for which IMF resources could be employed. Recall that the Articles indicated that a member was entitled to draw on IMF resources if it "represents that it is presently needed for making in that currency payments which are consistent with the provisions of the Agreement." This ambiguous provision raised concerns among some members of the U.S. Congress that IMF resources could possibly be used for any purpose, including the financing of "large or sustained" capital outflows, a practice that was seemingly prohibited under Article VI, Section I of the Fund's Articles of Agreement.[71] These Congressional opponents found strong support amongst U.S. Treasury officials who, as Joseph Gold (longtime General Counsel at the IMF) notes, were concerned that the Fund's resources "might be squandered in financing capital flight that maintained overvalued currencies."[72] Consistent with U.S. strategy during the Treasury system, their preferred approach to dealing with capital flight was economic adjustment via deflation.[73]

This was thus another matter on which the Congress, in approving the Bretton Woods Act, instructed the U.S. Governor and Executive Director to request an

[70] See again the discussion by Xenias (chapter 3 in this volume).

[71] Gardner, *Sterling-Dollar Diplomacy in Current Perspective*, p. 129 – 143.

[72] Joseph Gold, *International Capital Movements under the Law of the International Monetary Fund*, IMF Pamphlet Series No. 21 (Washington, DC: IMF, 1977), p. 23- 24.

[73] See Helleiner, *States and the Reemergence of Global Finance*, p. 57.

interpretation from the Board—an interpretation that would bar the use of IMF resources for purposes "beyond current monetary stabilization," and specifically ruling out operations "to meet a large or sustained outflow of capital."[74] Reflecting the U.S. position, the Fund's Board agreed that IMF resources could be drawn against only to give "temporary assistance in financing balance-of-payments deficits on current account for monetary stabilization operations."[75] This interpretation, as Joseph Gold observes, was "unduly restrictive" because it ignored provisions of the Articles that did permit financing "beyond current monetary stabilization," but it was entirely consistent with the aims of U.S. officials during this period: namely, promoting orthodox adjustment and a speedy move to convertibility.[76] By restricting states' ability to employ IMF resources to finance capital outflows, U.S. officials squarely placed the burden of adjustment on those states facing capital flight.

As a result, and in spite of the dollar shortage and the payments deficits facing Europe, the Fund's financing role in the early years of the Bretton Woods system was relatively minor. What little drawings there were on IMF resources tended to be by

[74] Section 13a of the U.S. Bretton Woods Agreement Act reprinted in Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Documents, p. 385.

[75] Executive Board Decision 71-2, 26 September 1946, reprinted in Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Documents, p. 245. See also Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. I, Chronicle, p. 148-149 and "Interpretations Requested by Resolutions Nos. 5 and 6 of the Inaugural Meeting of the Board of Governors, Prepared by the Legal Department, September 1946, Executive Board Document No. 55 (IMF Archives).

[76] Gold, *International Capital Movements under the Law of the International Monetary Fund*, p. 24.

developing countries;[77] and in 1950 not a single member state drew on the IMF's resources.[78] A major reason for this state of affairs was that the IMF's capacity to lend was paralyzed by debates among its member states about the rules that ought to govern access to its resources. Western European states, together with the IMF's Managing Director, Camille Gutt, continued to favor a Keynesian approach of automatic and unconditional lending; but U.S. officials, taking a more orthodox approach consistent with the practices they sought to promote during the Treasury system, argued for lending only after governments had agreed to adjustment policies that would eliminate the payments deficit.[79]

The U.S. blocked many attempts to use Fund resources during this period until the debate on conditionality was finally resolved in its favor.[80] Three Executive Board decisions stand out in these early debates on the use of IMF resources. First, following the logic suggested by Dam, in May 1947 the U.S. pushed through the following Board interpretation of the provision stating a member was entitled to draw on IMF resources if it "represents that it is presently needed":

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[77] Boughton, "Northwest of Suez: The 1956 Crisis and the IMF," IMF Working Paper WP/00/52 (Washington, DC: IMF, 2002).

[78] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. II, Analysis, p. 276

[79] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. I, Chronicle, p. 189, 223-226, 242-245, 278-282; James, *International Monetary Cooperation Since Bretton Woods,* p. 78-83.

[80] Frank Southard, *The Evolution of the International Monetary Fund*, Princeton Essays in International Finance No. 155 (Princeton, NJ: Department of Economics, Princeton University), p. 16; Block, op. cit, p. 110-112; Lisa Martin, "Distribution, Information, and Delegation to International Organizations: The Case of IMF Conditionality," in *Delegation and Agency in International Organizations*, edited by Darren Hawkins, David A. Lake, Daniel L. Nielson, and Michael J. Tierney (Cambridge: Cambridge University Press, 2006).

> The word "represents" in Article V, Section 3(a)(i) means "declares"…But the Fund may, for good reasons, challenge the correctness of this declaration, on the grounds that the currency is not "presently needed" or because the currency is not needed for payment "in that currency," or because the payments will not be "consistent with the provisions of this Agreement." If the Fund concludes that a particular declaration is not correct, the Fund may postpone or reject the request, or accept it subject to conditions.

This interpretation—subsequently confirmed in a March 1948 Board decision[81]—was a clear victory for the U.S. position. It permitted the Fund to challenge member state requests for resources and, as Horsefield notes, "effectively depart[ed] from the concept of an automatic right to draw on the Fund."[82]

Second, the U.S. pushed through an April 1948 Board decision that effectively barred recipients of Marshall Plan aid from using IMF resources.[83] This decision was intended both to prevent "double dipping" and to ensure a degree of control over policy developments in western Europe. As a result, the emphasis on Fund conditionality continued to some extent even during the period this volume identifies as the Marshall system, although it could be temporarily circumvented by accessing bilateral assistance from the U.S. through the European Recovery Program (which was subject to its own variety of conditionality).

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[81] IMF Executive Board Decision No. 284-4, 10 March 1948, reproduced in Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Documents, p. 227

[82] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. I, Chronicle, p. 189.

[83] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. I, Chronicle, p. 217-220; James, *International Monetary Cooperation Since Bretton Woods*, p. 78-79.

Finally, a February 1952 Executive Board decision outlined the procedures that were to govern future lending.[84] Though this decision would eventually allow European countries emerging from the ERP to make use of the Fund's resources, it too reflected the U.S. position. The new Managing Director at the Fund, Ivar Rooth, presented a plan in November 1951 (known as the "Rooth Plan") that effectively resolved the debate on the use of Fund resources. After extensive discussions and some modifications, the Rooth Plan was approved in a Board decision that defined the "conditions" the IMF could subject borrowers to as the "policies the member will pursue…to overcome the [balance-of-payments] problem."[85] From this point forward, these policies became the accepted meaning of IMF conditionality.[86] In addition, the 1952 decision established the now-familiar system of increased conditionality with increased borrowing, with the so-called "stand-by arrangement" as the principal vehicle of conditionality.[87]

Looking ahead, eventually the application of conditionality became more formalized, first in a series of Board decisions, later in the first amendment to the Articles

[84] Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation,* Vol. I, Chronicle, p. 321-326.

[85] Executive Board Decision No. 102-(52/11), 13 February 1952, reprinted in Horsefield, *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation,* Vol. III, Documents, p. 228.

[86] Drawing of the first 25 percent of a member's quota (the "gold tranche") would be more or less automatic, but for larger sums ("credit tranches") the IMF could impose conditionality and surveillance over the member's use of these resources. Although conditionality would vary from case-to-case, it generally took the form of stabilization programs where recipients were required to accept changes in their monetary, fiscal, credit, and exchange-rate policies as well as trade and payments practices.

[87] Under a stand-by arrangement, a member is assured of access to a specific amount of IMF financing for a fixed period of time under the conditions agreed.

in 1968, and finally in the "Guidelines of Conditionality" in 1979.[88] The conditions attached to stand-by arrangements were to be formally spelled out in the government's "letter of intent," which eventually came to include "performance criteria" by which the policy objectives of the program were to be addressed.

But to return to the earlier narrative, in 1947 the dollar and gold reserves of European governments were being rapidly depleted and they were unable to draw on the resources of the IMF. True, in coming years the U.S. would provide Europe with $13 billion of payments financing through the Marshall Plan; but in 1947 the shape, content, and timing of U.S. aid was still being formulated.[89] It was at this moment that the Bank became a significant actor in providing liquidity for Bretton Woods members, signaling the beginning of practices associated with the Marshall system.

c. Rediscovering the Bank's role

As I have suggested, the Bank's provision of liquidity in the Bretton Woods system was linked to evolution of internal debates about the appropriateness of this role; and it is to these internal debates that we now turn. The Bank was to be managed by a president and vice-president, with equal authority over lending operations assigned to the

[88] See Adolfo C. Diz, 1984, "The Conditions Attached to Adjustment Financing: Evolution of the IMF Practice," In the *International Monetary System: Forty Years after Bretton Woods* (Boston: Federal Reserve Bank of Boston), p. 224, 229 and Susan Strange, "International Monetary Relations," In *International Economic Relations of the Western World, 1959-1971*, edited by Andrew Shonfield (London: Oxford University Press, 1976), p. 92-97.

[89] Although Secretary of State George Marshall first suggested in May 1947 that some form of aid would be forthcoming, the Economic Cooperation Act that established the ERP was not enacted until 3 April 1948. The U.S. had also provided Europe aid through the United Nations Relief and Rehabilitation Administration (UNRRA) and other channels, but this too proved insufficient.

Loan and Research Departments.[90] Initially, the Bank's Loan Department was staffed mainly by bankers and lawyers, while the Research Department was manned primarily by economists; interdepartmental conflict was to be resolved in the Staff Loan Committee (later renamed the Loan Committee), made up of the principal department heads and chaired by the Bank's Vice President.[91]

Relations between the Loan and Research Departments were never harmonious and early in the Bank's history there was an important "battle of ideas" about how its resources should be used. Paul Rosenstein-Rodan, the Assistant Director of the Research Department and a leading development economist of the era, was the principal voice of the economists. In place of specific projects—which he saw as plagued by a "fungibility problem" (that is, financing investments that a government might have undertaken on its own)—Rosenstein-Rodan favored the general purpose or program loans that had been a part of White and Keynes's original vision for the Bank.[92] It was idle, Rosenstein-Rodan contended, for the Bank to concern itself with borrower creditworthiness and the merits of specific projects; rather, it should calculate the financing necessary to sustain a desired growth rate and then make massive loans available on a continuing basis. But for the

[90] World Bank, *First Annual Report*, p. 8; World Bank, *Second Annual Report*, (Washington, DC, 1946), p. 21; and Mason and Asher, *The World Bank Since Bretton Woods*, p. 74. The Research Department was renamed the Economics Department in 1948.

[91] Devesh Kapur, John P. Lewis, and Richard Webb, *The World Bank: Its First Half Century*, Volume 1 (Washington, DC: Brookings, 1997), p. 456.

[92] Paul Rosenstein-Rodan, Problems of Industrialization of Eastern and South-Eastern Europe, *Economic Journal* (1944); Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 128; Oliver; *International Economic Cooperation and the World Bank*, p. 272. See also the language in World Bank, *Fourth Annual Report*, (Washington, DC: World Bank, 1949), p. 9, which was crafted by two Bank staff economists. Due to the emergence of the project-oriented culture, this language was never repeated.

bankers and lawyers in the Loan Department—who viewed creditworthiness as the key factor determining a borrower's eligibility for financing—this advice, according to one of the Bank's historians, "seemed like nonsense."[93]

This battle for control of the Bank's agenda took on added significance because of personnel problems at the top of the organization. The Bank's first president, Eugene Meyer, resigned only four months after the Bank opened its doors; John J. McCloy became the Bank's second president in March 1947 and immediately faced the issue of what the Bank's role should be in Europe. By April 1947, the Bank had received formal applications for financing from six European countries, and still another was received in August. But the Bank was still very much in its infancy and its organizational culture that is, the formal and informal ideologies, norms, language and routines that would eventually govern Bank operations—had yet to be established. No one in the Bank really knew where to begin, what types of questions to ask, or what sort of investigations to undertake in response to these requests.

At this point geopolitical concerns began to loosen the extent to which U.S. officials applied the restrictive practices of the Treasury system. For example McCloy was encouraged to lend to France, one of the countries which had applied for a loan, in order to shore up the government vis-à-vis the Communist Party (which had a minor position in government and was seen as likely to increase its mandate in the next elections).[94] This encouragement marked the beginning of the transition to the Marshall system.

[93] Oliver; *International Economic Cooperation and the World Bank*, p. 272

[94] Kai Bird, *The Chairman: John J. McCloy and the Making of the American Establishment*, (New York: Simon and Schuster, 1992), p. 290.

Equally important, and quite the opposite of the situation at the Fund, U.S. officials at the Bank were indifferent about the form IBRD lending was to take. Though recognizing that Europe needed a massive disbursement of aid, McCloy was uncertain as to whether it should take the form of project or program loans; and it was in this environment that Rosenstein-Rodan and his economist colleagues managed to persuade McCloy to recommend program rather than project loans to the Board. As McCloy's biographer notes: "[T]hough he had not initially been prepared to endorse such lending, McCloy was quickly convinced by the Bank's senior economists that Europe's war-torn economies needed such balance-of-payments financing."[95]

McCloy also recommended program loans for four other countries, all of which which were approved by 1948. The significance of these loans is usually either unexamined or ignored altogether in the existing literature, partly because ERP aid would soon dwarf the amount the Bank loans provided. But the impact of these loans should not be assessed in terms of their amount relative to the ERP over time; rather, their impact should be gauged in terms of the alternative sources of financing available at the time—that is, prior to the ERP.

From the end of the war through the implementation of the ERP in spring 1948, sources of reserves and credit were in short supply. European countries did draw on the Fund for some financing, but these credits were relatively small in comparison to the resources the Bank offered. Prior to the initiation of the ERP, the Bank provided $497

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[95] Bird, *The Chairman*, p. 291. See also Mason and Asher, *The World Bank Since Bretton Woods*, p. 51-52.

million in general payments financing to western Europe, whereas the Fund disbursed only $264.1 million.[96] Moreover, as one of the Fund's historians characterizes it, the Bank's contribution to the provision of liquidity at this time, "though quite limited in quantitative terms," was "strategically significant."[97]

Certainly the Bank staff seem to have been aware of the critical importance of these loans. In the IBRD's third *Annual Report* the Bank staff observed that "these loans, by permitting the borrowing countries to sustain for a time the necessary volume of essential imports, helped to prevent a disastrous drop in production and possible economic collapse."[98] Thus Bank financing allowed, as Keynes had wanted, a "breathing space" for these countries to begin the road toward economic recovery and payments equilibrium. And this practice eventually became relatively routine. Between 1950 and 1957 the Bank's Board approved an additional eleven program loans, totaling $523.5 million, to five countries.[99] These loans were for the most part driven by the successful efforts of Bank economists to persuade the Bank's next president, Eugene Black (who replaced McCloy in July 1949), to recommend them to the Board for approval.[100] Throughout this period, the Bank's Board tended to greet requests for program loans with

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[96] Data are from World Bank, *Annual Report*, (Washington, DC: World Bank, various years) and *The International Monetary Fund, 1945 – 1965: Twenty Years of International Monetary Cooperation*, Vol. III, Analysis (Washington, DC: IMF), p. 460-463. The Bank also provided an additional $90 million in program loans to Western Europe during the Marshall Plan era (1948 – 1951).

[97] James, *International Monetary Cooperation Since Bretton Woods*, p. 73.

[98] World Bank, *Third Annual Report*, (Washington, DC: World Bank, 1948), p. 8.

[99] Mason and Asher, *The World Bank Since Bretton Woods*, p. 264fn11, 269-275.

[100] Mason and Asher, *The World Bank Since Bretton Woods*, p. 268-269 and Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 134. See also the memorandum from Economic Department Director Leonard Rist to President Black promoting the virtues of program loans, quoted in Mason and Asher, *The World Bank Since Bretton Woods*, p. 269.

great enthusiasm. Although a few Board members remained skeptical of program lending, none of these requests for program loans triggered any debate on the Board about their underlying legitimacy.[101]

Thus while the announcement of Marshall Plan aid marked a strategic shift in U.S. policy, it was the Bank's provision of liquidity rather than the later disbursement of ERP aid that marked the beginning of the transition from the Treasury to Marshall system. Though the simultaneous development of the principles of loan conditionality at the Fund undermined the norm and later sharply curtailed the practice of national policy autonomy, at the time the Bank's loans brought a generous supply of liquidity and signaled a greater appetite on the part of the Unites States for policy accommodation—practices that became leading characteristics of the Marshall system. The combination of the European payments crisis and the changed geopolitical environment helped convince U.S. officials of the need to change their policy orientation; but it was the availability of the Bank that made it possible to implement this new policy framework almost immediately, rather than awaiting the eventual establishment of the ERP.

4. Removing the Bank from liquidity provision: the emergence and impact of the project culture

The 1947-1948 program loans, however, marked the high point of the influence of economists on Bank lending policy; over the next four years their views within the Bank would become increasingly marginalized. An alternative perspective came to dominate

[101] Mason and Asher, *The World Bank Since Bretton Woods*., p. 270-273.

Bank operations, one that prioritized specific projects as the appropriate institutional norm.

As noted above, the bankers and the lawyers in the Loan Department had generally objected to the Board's approval of program loans; and their arguments were received sympathetically by Vice President Robert Garner, to whom McCloy delegated considerable responsibility. As Vice President, Garner chaired the Staff Loan Committee and, as one Bank historian notes, was "probably more responsible than any other single person for the evolution of the Bank through the mid-fifties." Garner did not understand and had little patience with the Bank's economists.[102] He generally opposed program loans and felt that the Bank should confine itself to financing specific capital infrastructure.[103]

In 1948, the Loan Department's Assistant Director persuaded Garner to remove any responsibility over Bank lending operations from the Economics Department.[104] As a result, the views of the bankers and lawyers in the Loan Department tended to prevail, and Bank lending became increasingly oriented toward financing specific projects.[105] The emergence of this project-oriented culture and the Bank's subsequent removal from the liquidity architecture was reinforced by a realignment of Bank personnel. Between 1949

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[102] Oliver, in *International Economic Cooperation and the World Bank*, p. 239. Oliver also notes that Garner would blue pencil terms like "capital-output ratio" out of reports, calling them "economeeze."

[103] Oliver, *International Economic Cooperation and the World Bank*, p. 239-240 and Jochen Kraske, *Bankers with a Mission: The Presidents of the World Bank, 1946-1991* (Washington, DC: World Bank, 1992), p. 55, 90-91.

[104] Oliver, *International Economic Cooperation and the World Bank*, p. 273.

[105] World Bank, *Fourth Annual Report* (Washington, DC: World Bank, 1949), p. 7, 8; Mason and Asher, *The World Bank Since Bretton Woods*, 155, 458-461; Oliver, *International Economic Cooperation and the World Bank*, pp. 25, 246; Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, pp. 105-106.

and 1960, the Bank underwent “a virtual revolution in Bank staffing.”[106] Driven in part by the need for technical expertise to evaluate capital infrastructure projects, the Bank recruited engineers on a massive scale, altering the personnel profile of the Bank in a “pro-projects direction.”[107] As engineers, these new staff members tended to view development as a sequence of new physical structures or projects to be put in place, and thus favored specific project loans.[108]

In 1952 the development of this project-oriented culture was further strengthened when the Bank’s internal departments were reorganized. According to one Bank historian, “the primary reason for the reorganization of 1952 was to give the loan or operations (area) departments more power, and the research or economics department less power.”[109] The most powerful department in the Bank became the new project-oriented Technical Operations Department (TOD).[110] The creation of the TOD facilitated the recruitment of additional engineers and project specialists, thus further strengthening their views within the Bank. Meanwhile, the Economics Department lost its departmental status. Some economists, such as Rosenstein-Rodan, left the Bank, while

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[106] Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 457.

[107] Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 458.

[108] Paul Mosley, Jane Harrigan, and John Toye, *Aid and Power: The World Bank and Policy-based Lending*, Volume 1 Analysis and Policy Proposals (London:Routledge, 1995), p. 29; Robert Sadove, “Economists, Engineers, and Development,” *Finance and Development* 4, no. 2.

[109] Oliver, *International Economic Cooperation and the World Bank*, p. 173.

[110] Oliver, *International Economic Cooperation and the World Bank*, p. 100, 158; Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 129-130.

others joined the other departments; those that remained tended to adopt the project-oriented culture.[111]

In this project-oriented culture, staff recommendations for program loans tended to be rare and, when advanced, generally met with opposition.[112] Whereas program loans constituted 73.2 percent of Bank financing from 1946 to 1950, these loans constituted only seven percent of approved financing from 1951 to 1957.[113] Looking back on its first decade of operations, the Bank's *Annual Report* notes: "The most typical pattern of lending has been and will continue to be a series of single loans, made over a period of time, to finance imports for a variety of single projects."[114]

Meanwhile, the Board, which had been so enthusiastic about such loans earlier, lacked the capacity to initiate them on its own authority.[115] In contrast to the Fund, where the Executive Board retained considerable control over lending operations through the 1950s, McCloy had established early in his tenure that management and staff would be responsible for such decisions. Indeed the unique circumstances surrounding McCloy's appointment enabled him to wield a greater degree of autonomy over lending decisions than that provided to the Fund's managing director.

Earlier, U.S. Executive Director Emilio Collado had sought to construct the Bank as an institution that would be led by a powerful Board, a course that had precipitated

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[111] Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 129-130; Oliver, *George Woods and the World Bank* (Boulder, CO: Lynne Rienner, 1995), p. 100.

[112] Mason and Asher, *The World Bank Since Bretton Woods*, p. 271.

[113] Author calculations based on World Bank, *Annual Report*, (Washington, DC: World Bank, various years)

[114] World Bank, *Tenth Annual Report* (Washington, DC: World Bank, 1955), p. 32.

[115] Mikesell, *United States Economic Policy and International Relations*, p. 200.

Meyer's resignation. Following Meyer's departure, the Truman administration had difficulty finding a suitable successor. When asked to serve as the Bank's second president, McCloy was advised by Meyer, Chester McClain (the Bank's General Counsel) and Black (then vice president of Chase National Bank) to insist on proper executive authority as a condition for accepting the position. McCloy then met with Truman administration officials and presented a list of conditions that would have to be in place before he accepted the position. He demanded that the U.S. not interfere in loan negotiations nor exercise its "gatekeeping" power by giving prior indication of U.S. positions on loan applications; that he would have a free hand in hiring and dismissing staff and administration; and that he would have the right to select the U.S. Director.[116]

After securing the Truman administration's agreement, McCloy then negotiated a division of responsibilities between the management, staff, and Board, an arrangement later formalized by the Board's Committee on Organization in June 1947. Under the terms of this agreement, the Board was responsible for policy decisions; however, recommendations for policy were to come exclusively from management and staff. The Board was to be kept informed of the progress of the staff's operational work, but management and staff would decide whether a loan application was to be pursued and how its contents were to be designed.

The initial reactions of some Board members to these demands illustrate the degree to which McCloy was able to act independently of their influence. The British Director bluntly called McCloy's conditions an "ultimatum;" but given the Bank's

[116] McCloy subsequently selected Black to replace Collado as U.S. Executive Director. Bird, *The Chairman*, p. 286; Catherine Gwin, "U.S. Relations with the World Bank," in *The World Bank: Its First Half Century*, Volume 2, edited by Devesh Kapur, John P. Lewis, and Richard Webb, (Washington, DC: Brookings, 1997), p. 200.

diminishing capacity to function in the absence of a president, he and the other members of the Executive Board reluctantly agreed. Reflecting the strength of McCloy's position, the British Director reported back to London: "What happens now I don't know but I must say that dirt is a disagreeable diet."[117] Similarly, later in his term when the directors lined up for a group photo with McCloy, one director reportedly joked, "Why don't the members pose with their rubber stamps in their hands?"[118]

As a result, and in sharp contrast to the Fund, the Bank's management and staff acquired considerable autonomy with respect to loan decisions in the earliest years of the Bretton Woods system. This autonomy was further strengthened by informational considerations. As the Bank's operations evolved, loan designs eventually required a degree of accumulated expertise and information that the Executive Directors and their staffs simply could not provide.[119] As a result, Board members found it difficult to object to staff recommendations on technical grounds.[120] (Similar conditions eventually

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[117] Bird, *The Chairman*, 286.

[118] Bird, *The Chairman*, 300.

[119] William Asher, "New Development Approaches and the Adaptability of International Agencies: The Case of the World Bank," *International Organization* 37, no. 3, p. 421.

[120] Asher, "The World Bank and U.S. Control;" Robert L. Ayres, *Banking on the Poor: The World Bank and World Poverty* (Cambridge, MA: MIT Press, 1984), p. 66; and Ngaire Woods, "The Challenges of Multilateralism and Governance," in *The World Bank: Structure and Policies*, edited by Christopher Gilbert and David Vines (Cambridge, UK: Cambridge University Press, 2000), p. 140. As Asher notes in "New Development Approaches and the Adaptability of International Agencies," p. 421: "In practice, the Executive Directors veto a project only under extraordinary circumstances and have virtually no opportunity to initiate the consideration of specific projects."

led the IMF staff to have increased autonomy with respect to loan decisions, but in the Fund's case this did not happen until the 1950s.[121])

This increased autonomy from the Board provided the Bank's staff with significant agenda-setting and gatekeeping powers; and with these powers firmly in the hands of a project-oriented staff, the Bank was effectively removed from its liquidity provision role. The Bank approved no program loans between 1957 and 1966; and in contrast to the Fund, the Bank's Board made little effort to resolve the ambiguous "special circumstances" language in the specific project provision, leaving the Bank's staff to interpret this key matter instead. "By the end of the 1950s," the Bank's historians observe, "the culture of the Bank had become project-led" and "this project culture…had a marked effect on the Bank's history."[122] Despite Keynes' and White's plans for the Bank to offer monetary stabilization and program loans, and despite the IBRD's own early history in this regard, "the Bank's clear authority in this regard was allowed to atrophy."[123]

5. Conclusion

As we have seen, ambiguous passages in the Articles of Agreement concerning access to the IMF's resources and the Bank's role in the provision of liquidity turned out to have significant implications for how the early Bretton Woods system evolved. At the Fund, ambiguous provisions governing access to the IMF resources produced intense

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[121] See Martin, **"**Distribution, Information, and Delegation to International Organizations: The Case of IMF Conditionality.".

[122] Kapur, Lewis, and Webb, *The World Bank: Its First Half Century*, Volume 1, p. 8, 9.

[123] Dell, "A Note on Stabilization and the World Bank," p. 165.

rivalry among IMF member states that ultimately paralyzed the IMF's capacity to serve as a provider of short-term stabilization loans—paralysis that helped provoke the Marshall Plan, which in turn further diminished the Fund's its role as a source of liquidity.[124] Furthermore, the development of the doctrine of conditionality meant that the Fund's commitment to the norm of policy autonomy had been permanently reduced.

On the other hand, ambiguous provisions in the Bank's Articles and a Board decision forced by a powerful president left the evolution of its role as a liquidity provider largely in the hands of its staff. The ebbs and flows of intra-organizational contestation then shaped whether the Bank took on this role at particular moments. Early in its history, with the Fund paralyzed by internal debates and before Marshall Plan aid was available, program-oriented staff at the IBRD saw to it that European countries received infusions of liquidity enabling them to achieve a measure of domestic policy autonomy. The Bank thus played a critical role in the transition from the Treasury to the Marshall system; but a decade later, at almost precisely the same time the Fund began to emerge as a liquidity provider, the ascendance of project-oriented staff led the Bank to abandon its early role in this area. As a result, researchers looking for instances where the IMF and Bank operated in the mutually-supportive and complementary fashion that Keynes and White originally intended will largely search in vain.

[124] The Fund would only begin to recover this role following the 1956 Suez crisis, with its provision of financing to Britain.